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POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268–0001

COMPETITIVE PRODUCT LIST ADDING ROUND-TRIP MAILER	Docket No. MC2013-57
COMPETITIVE PRODUCT LIST ADDING ROUND-TRIP MAILER	Docket No. CP2013-75

UNITED STATES POSTAL SERVICE REPLY TO COMMENTS
(August 22, 2013)

On April 20, 2011, the Postal Regulatory Commission issued Order No. 718 in PRC Docket No. C2009-1, finding that the United States Postal Service failed to establish reasonable and legitimate reasons for the different mail processing methods applied to GameFly, Inc. and other round-trip DVD mailers, and that its mail processing decisions regarding round-trip DVD mail violated 39 U.S.C. § 403(c). Docket No. C2009-1, Order No. 718 - Order on Complaint, at 108, ¶¶ 5004-5005 (Apr. 20, 2011). As a remedy, the Commission specified a "reduced rate for round-trip flat-shaped DVD mailers weighing up to two ounces" equal to the one ounce flat rate. *Id.* at 113-115, ¶¶ 5022, 5027-5028. On May 20, 2011, GameFly filed a Petition for Review with the United States Court of Appeals for the District of Columbia Circuit challenging the Commission's remedy in PRC Docket No. C2009-1. *GameFly, Inc. v. PRC,* Petition for Review, Case No. 11-1179 (May 20, 2011). On January 11, 2013, the Court issued its opinion vacating the Commission's order and remanding the case. *GameFly, Inc. v. PRC*, 704 F.3d 145, 149 (D.C. Cir. 2013).

On June 26, 2013, the Commission issued Order No. 1763, specifying a new remedy that required the Postal Service "to equalize the rates for letter-shaped and flat-shaped round-trip DVD mailers either by establishing new equalized rates for such letter-shaped and flat-shaped round-trip DVD mailers, or by reducing the price for a two-ounce First-Class flat-shaped round-trip DVD mailer to the price for a one-ounce First-Class letter-shaped round-trip DVD mailer." Docket No. C2009-1R, Order No 1763 – Order on Remand, at 1 (June 26, 2013) (*hereafter* "Order 1763"). After recognizing that the Commission's new remedy raised complex issues and that compliance would require approval from multiple stakeholder groups, including the Board of Governors, the Postal Service requested an extension of time for compliance. United States Postal Service Motion for Extension of Time in Which to Comply with Order No. 1763, Docket No. C2009-1R (July 19, 2013). On July 23, 2013, the Commission denied that request. Order Denying Motion for Extension of Time, Order No. 1787, Docket No. C2009-1R (July 23, 2013).

On July 25, 2013, the Postal Service moved for reconsideration and clarification of Order No. 1763. On August 13, 2013, the Commission addressed the Postal Service's motion in Order No. 1807. Docket No. C2009-1R, United States Postal Service Motion for Reconsideration and Clarification of Order No. 1763 (July 25, 2013) (*hereafter* "Motion for Reconsideration"). On July 26, 2013, the Postal Service provided notice of the creation of a new competitive product, tentatively titled Round-Trip Mailer, to replace the existing Round-Trip Mailer option on the Market-Dominant product list. Docket No. C2009-1R, Request of the United States Postal Service Under Section 3642 To Create Round-Trip Mailer Product (July 26, 2013) (*hereafter* "Request"). On August 15, 2013, GameFly and Netflix filed comments in response to the Postal Service's notice. Docket No. C2009-1R, Comments of GameFly, Inc. On USPS Proposal to Reclassify DVD Mailers as Competitive Products (August 15, 2013) (*hereafter* "GameFly Comments"); Docket No. C2009-1R, Comments of Netflix, Inc. (August 15, 2013) (*hereafter* "Netflix Comments"). This pleading responds to these comments.[1]

[1] The Postal Service submits declarations from Mark Schoeman (Attachment A), Virginia J. Mayes (Attachment B), A. Thomas Bozzo (Attachment C), and Steven W. Monteith (Attachment D) with this Reply.

As discussed in more detail below, the comments submitted in these dockets fail to provide a compelling basis for rejecting the new Competitive Product. As described in Section I below, and more extensively in the Postal Service's initial Request, the Round-Trip Mailer product satisfies all of the requirements for a competitive product. As described in Section II below, the Postal Service's mail delivery of digitized entertainment content, including the DVDs shipped by GameFly and Netflix, faces competition from multiple physical delivery alternatives – including kiosks and retail outlets – and digital delivery alternatives – including streaming through the internet and cable, and downloading over the internet. As described in Section III below, witness Glick's contentions regarding Postal Service data submitted in support of the section 3642 filing are inaccurate. And finally, as described in Section IV below, Order No. 1807 does not diminish the importance of these dockets.

Accordingly, the Postal Service requests that the Commission approve its section 3642 filing.

I. THE ROUND-TRIP MAILER PRODUCT MEETS THE DEFINITION OF A PRODUCT UNDER 39 U.S.C. § 102 (6).

In its Comments, Netflix argues that the proposed Round-Trip Mailer product does not fit the definition of a product under 39 U.S.C. § 102 (6), because it is an inappropriate amalgamation of four different products within First-Class Mail. Netflix Comments, at 4. Netflix goes on to argue that the Round-Trip Mailer fails to meet the requirements of section 102(6), because the product consists essentially of "one very larger mailer and one very small mailer." These arguments simply aren't borne out by the facts.

Section 102(6) defines a product as "a postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be applied." The Commission has previously recognized that this definition is so broad that "almost any category of mail would qualify." Order No. 536, Order Adopting Analytical Principles Regarding Workshare Discount Methodologies, at 22 (Sept. 14, 2010). Given the broad nature of this definition, the

Commission has stated that when determining whether a proposal constitutes a product it "must consider the context." Order No. 1657, Order on Elective Filing Regarding Post Office Box Service Enhancements, at 17 (February 14, 2013). Here, the context clearly supports the notion that the Round-Trip Mailer is a product under section 102(a).

First, as discussed in more detail in Section II of these Reply Comments, the Round-Trip Mailer product competes within a distinct market (the market for digitized entertainment content) that has unique demand characteristics. Additionally, contrary to Netflix's assertion, it is not unprecedented for the Postal Service to "cobble" together different products into a combined offering. For example, the Postal Service created Express Mail in 1970 from elements of Air Mail and Special Delivery, and routinely creates Negotiated Service Agreements that combine different products into a single agreement. *See, e.g.* Express Mail & Priority Mail Contract 1 (MC2009-6); Parcel Select & Parcel Return Service Contract 1 (MC2009-11). Moreover, the very nature of the Round-Trip Mailer product stems from the Commission's decision in Docket No. C2009-1, where it proposed Mail Classification Schedule language that created a round-trip DVD product. The only difference between the product proposed by the Commission and the product proposed by the Postal Service, is that the Postal Service wishes to classify the product as Competitive. Taken together, this evidence clearly indicates that the round-trip mailer product falls within the definition of a product under Section 102(6)

Regardless, Netflix's arguments are rendered moot, so long as the Round-Trip Mailer product satisfies the objectives and factors listed under 39 U.S.C. § 3642 and 3633, and 39 C.F.R. 3020.30 *et seq*. As discussed more thoroughly in Section II of this pleading and in the Postal Service's initial request, the proposed Round-Trip Mailer product complies with the statutory objectives and factors.

II. THE ROUND-TRIP MAILER PRODUCT PROPOSED BY THE POSTAL SERVICE COMPLIES WITH 39 U.S.C. § 3642(b)(1).

As identified in the Comments submitted by GameFly, the Commission must consider whether the Postal Service's proposed Round-Trip Mailer Product complies with 39 U.S.C. § 3642(b)(1). GameFly challenges the Postal Service's proposal by presenting an incomplete and inaccurate definition of the relevant market for purposes of determining compliance with section 3642(b). As we describe in more detail below, the relevant market for purposes of this docket is the provision of access to digitized entertainment content to consumers.[2] Consumers can receive this access to digitized content in many different ways that do not involve the Postal Service or even physical delivery. The Postal Service's delivery of digitized entertainment content through the mail faces extensive competition from numerous digital and physical methods, and if the Round-Trip Mailer becomes a competitive product, this competition would restrict the Postal Service's ability to price the Round-Trip Mailer above a competitive level. The simplistic approach urged by GameFly—that the Postal Service is the only one offering round-trip DVD mailers, therefore it is a monopolist whose products should be treated as market dominant—is inconsistent with sound antitrust principles established by the federal courts and implemented by other federal agencies, such as the Federal Communications Commission and Surface Transportation Board. The key issue for the Commission is whether digital and physical methods of delivering digitized entertainment content compete sufficiently with the Postal Service's mail delivery to restrict the Postal Service's ability to charge prices for the Round-Trip Mailer that are above competitive levels. As described in more detail below, the existence of competition from numerous physical and digital methods of delivering digitized entertainment content, the development of new delivery methods, and the cost structure of the product

[2] Throughout this brief, we use the phrase "provision of access to digitized entertainment content" to distinguish this market from the actual production of such content by movie, television, and video game studios.

demonstrate that the Postal Service will not have the ability to price a competitive Round-Trip Mailer product above competitive levels.

The Postal Service is not market dominant in this product, and the product therefore should be added to the competitive product list.

A. The Postal Service's Request to Transfer Round-Trip DVD Mailers from the "Market-Dominant" Product List to the "Competitive" Product List Should Be Assessed According to Federal Antitrust Principles.

The Commission should apply federal antitrust principles in assessing the permissibility of the Postal Service's request to transfer round-trip DVD mailers from the "market-dominant" product list to the "competitive" product list.

The text of the statutes and regulations governing the listing of mailing products clearly indicates that antitrust principles developed by the federal courts should apply. the Postal Service proposes this transfer pursuant to 39 U.S.C. § 3642, which permits the Commission to "change the list of market-dominant products under section 3621 and the list of competitive products under section 3631 by adding new products to the lists, removing products from the lists, or transferring products between the lists." 39 U.S.C. § 3642(a). Section 3642 instructs that the Commission's ultimate determination of the permissibility of a proposed transfer shall be made in accordance with in the terms of 39 U.S.C. § 3642(b), which invokes antitrust concepts on its face:

> The market-dominant category of products shall consist of each product in the sale of which the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products.

39 U.S.C. § 3642(b)(1); *compare with Jacobs v. Tempur-Pedic Int'l, Inc.*, 626 F.3d 1327, 1339 (11th Cir. 2010) ("[m]arket power is the ability to raise price significantly above the competitive level without losing all of one's business") *and Virgin Atl. Airways Ltd. v. British Airways PLC*, 257 F.3d 256, 265 (2d Cir. 2001) ("Market power is defined as 'the ability of a single seller to

raise price[s] and restrict output.'") (quoting *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 464 (1992)). The relevant implementing regulations similarly invoke antitrust concepts. *See* 39 C.F.R. § 3020.32(d) ("Verify that the change does not classify as competitive a product over which the Postal Service exercises sufficient market power that it can, without risk of losing a significant level of business to other firms offering similar products: (1) Set the price of such product substantially above costs; (2) Raise prices significantly; (3) Decrease quality; or (4) Decrease output.").

By adopting the established antitrust framework for its analysis, the Commission will align itself with the practices of federal agencies charged with construing and applying similar federal requirements. Indeed, federal agencies routinely rely on antitrust principles to assess whether regulated entities are "dominant" (*i.e.,* possess market power) in particular relevant markets. *See, e.g.*, Motion of AT&T Corp. to be Re-Classified as a Non-Dominant Carrier, Order, 11 FCC Rcd. 3271, 3285-3347 (1996) (reclassifying AT&T as non-dominant in the provision of interstate long-distance service upon finding that it lacked individual market power); Petition of Qwest Corp. for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Phoenix, AZ, Metropolitan Statistical Area, 25 FCC Rcd. 8622 (2010) (denying Qwest's petition for regulatory relief on ground that Qwest had failed to demonstrate that it lacked market power); *CF Indus., Inc. v. Surface Transp. Bd.*, 255 F.3d 816, 822-24 (D.C. Cir. 2001) (endorsing Surface Transportation Board's employment of antitrust concepts of market dominance in applying its relevant governing statutes). GameFly agrees that antitrust principles govern this inquiry, arguing that such principles support maintaining market-dominant rates for DVD mailings. *See, e.g.*, GameFly Comments at 7-11, 12, *Competitive Product List Adding Round-Trip Mailer*, No. CRP2013-75/MC2013-57 (Aug. 15, 2013), Filing ID No. 87621.

B. The Postal Service Does Not Exercise "Market-Dominance" with Respect to Round-Trip DVD Mailers.

Round-trip DVD mailers should be classified as competitive because the Postal Service is not "market-dominant" with respect to round-trip DVD mailers. "Market dominance" occurs when a party has "market power." *See Albani v. So. Ariz. Anesthesia Servs.*, 1997 WL 718499, at *3 (D. Ariz. Jan. 27, 1997) (citing *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456 (1993) for the proposition that "[i]t is through evidence of market dominance that the jury may measure [a] defendant['s] ability to lessen or destroy competition"). "Antitrust plaintiffs generally prove a defendant's market power by defining a relevant market and indicating the percentage share of the market possessed by the defendant." *Meijer, Inc. v. Barr Pharms., Inc.*, 572 F. Supp. 2d 38, 54-55 (D.D.C. 2008); *see also Newcal Indus., Inc. v. Ikon Office Solution*, 513 F.3d 1038, 1045 (9th Cir. 2008) (explaining that market power can only be assessed with reference to a legally cognizable "relevant market").

Gamefly's premise—that the relevant market that the Commission should consider is the narrowly defined market of DVDs delivered through the mail—is inconsistent with governing antitrust principles. The Supreme Court has declared that "[t]he outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962); *see also F.T.C. v. Whole Foods Mkt., Inc.*, 548 F.3d 1028, 1038 (D.C. Cir. 2008). The Postal Service's "market-dominance," or lack thereof, thus must be analyzed within the context of the downstream markets in which GameFly and Netflix compete. Properly construed, the relevant market in which GameFly and Netflix operate is the market for the provision of access to digitized entertainment content. The round-trip DVD mailer is one of many ways that companies such as Netflix and GameFly can provide this access to digitized entertainment content to consumers.

Instead, as discussed below, the evidence clearly demonstrates that the provision of access to digitized entertainment content is a dynamic and rapidly evolving market in which competing firms use alternative distribution methods to deliver product to their customers and in which neither GameFly, nor Netflix possesses market power. The presence of these downstream competitors and the availability of alternative distribution methods effectively prevent the Postal Service from exercising market power in distributing DVDs.

1. Intense competition in the downstream market for digital entertainment content and increasing substitution towards alternative distribution methods will prevent the Postal Service from setting prices above a competitive level.

The Postal Service simply cannot raise the price of its round-trip DVD mailer above competitive levels without losing money. This is because there are many alternative delivery methods, particularly streaming via broadband connections, that are growing and supplanting mail delivery.[3] As described in more detail below, both GameFly and Netflix face increasing competition from providers of access to digitized entertainment content that use less expensive and arguably more convenient delivery methods.

Competition will constrain the Postal Service from attempting to raise the price of its return-mail product above competitive levels. If the Postal Service were to attempt to raise its price and if GameFly and Netflix tried to pass that cost increase onto consumers in the form of higher retail prices, demand would drop sufficiently to reduce profits for GameFly, Netflix, *and*

[3] The Commission has identified similarities between electronic delivery of content and mail delivery of content. *See* Notice and Order Concerning Proposed Amendment to the Commission's Rules of Practice and Procedure, Order No. 1424, PRC Docket No. RM2004-1 (November 12, 2004) at 38 ("[a]s the Commission noted in Order No. 1239, 'a colorable claim [was made] that [Post ECS service] not only is very closely related to the carriage of mail, it is the delivery of mail because it accomplishes by electronic means all the functions that would otherwise be performed by conveying a physical message or document") (internal citations and emphasis omitted); Review of Nonpostal Services under the Postal Accountability and Enhancement Act, Order No. 154 (December 19, 2008) at 38 (stating that hardcopy and electronic international money transfer services serve the same function). Similarly, GameFly acknowledges that the Postal Service loses volume to electronic alternatives. GameFly Comments at 12-14.

the Postal Service. The Commission's analysis thus must begin by examining the market in which GameFly and Netflix operate, the alternative delivery methods available to competitors in *that* market, and the rapidly evolving preferences of consumers regarding methods for delivering entertainment content.

2. The "relevant market" for purposes of assessing the Postal Service's market-dominance is the market for access to digitized entertainment content.

The market for access to digitized entertainment content is a highly differentiated market, where the products offered by competing providers differ in a number of product characteristics. For example:

The content itself differs. In the case of video entertainment, some providers focus on television shows, while others focus on movies, and others feature a mix of the two; and the nature and number of the video offerings may vary.

Products also vary in price. Some providers rent videos and charge a price for each film while others offer a subscription service. And some, like Amazon, may offer both a subscription service for older films and TV shows, but charge for newer or more popular videos. Other competitors, including Amazon, sell video content.

Finally, the products differ in the way they are delivered. Again using the example of videos, initially most providers rented videos out of physical stores, and customers had to go to the store to pick up and then return the videos. As new delivery methods were introduced, these video stores fell out of favor and most have closed. Netflix introduced the concept of ordering videos online and having them delivered to the customer in a return-mailer. While Netflix had great success with this form of delivery, it too lost some popularity as two new delivery vehicles were introduced – streaming over broadband connections and delivery through kiosks. In evaluating this market, then, one cannot ignore the delivery method as an important product characteristic.

Rather than considering these dynamics, GameFly proposes the following simplistic and analytically flawed approach to suggest that the Postal Service is market dominant. First, GameFly points out in a single sentence that the Postal Service is the only firm offering round-trip DVD mailers. *Id.* at 4. From this point, it concludes that the Postal Service is a monopolist in the provision of round-trip DVD mailers. GameFly Comments at 5. If the Postal Service is a monopolist, this argument runs, it must be market dominant. But this approach is flawed because it ignores the true market dynamics and inappropriately tries to limit the Commission's competition analysis to a single product that competes among many.

Put another way, GameFly's argument that the Postal Service is "market-dominant" can only succeed if the Commission accepts Gamefly's inappropriately narrow definition of the relevant market as "the delivered product carried by the regulated carrier (here, DVDs)." GameFly Comments at 9. GameFly's definition confuses the *method of delivery of the relevant product* (mail, internet streams, physical vending machines, cable boxes, etc.) with the *relevant product itself*—access to digitized entertainment content. The Postal Service's mail-delivery products, in turn, are simply one method that a small number of firms—almost entirely Netflix and GameFly—employ at this time to provide consumers digitized entertainment content. All of the firms that provide access to digitized entertainment content to consumers—regardless of the specific delivery method(s) they employ—compete with Netflix and GameFly in the same market. The "relevant market" is thus comprised not simply of services that provide access to digitized entertainment content to consumers through the mail, but also services that provide that content to consumers for sale or rental by other means, including internet streams, cable-based video on demand, downloaded content, and physical kiosks. GameFly's arguments to the contrary fly in the face of deeply established federal precedent and the economic realities of existing and evolving entertainment content markets.

a. <u>Federal antitrust law does not recognize separate markets for interchangeable products that are simply distributed or delivered differently.</u>

GameFly argues that the relevant market for purposes of the competition analysis is the market for delivery of DVDs through the mail. GameFly's urges the Commission to treat companies offering interchangeable content (i.e., access to digitized entertainment) as operating in separate markets simply because those firms deliver that content to consumers through differing methods. Phrased differently, GameFly argues that a consumer who streams Season 1 of Breaking Bad from Netflix is in a different market from a consumer that rents the physical DVD containing Season 1 of Breaking Bad from Netflix.[4]

The federal courts have repeatedly rejected attempts to define markets in terms of distribution methods when those methods are employed to distribute products that consumers consider equivalent. *See, e.g.*, *PepsiCo, Inc. v. Coca-Cola Co.*, 114 F. Supp. 2d 243, 249-50 (S.D.N.Y. 2000) (rejecting a market confined to fountain syrup delivered through independent foodservice distributors; court commented that "while customers view fountain syrup delivered through independent foodservice distributors as preferential and advantageous, they view fountain syrup delivered through other means as acceptable," and concluded that "the mere preference for one form of delivery over another does not create separate markets for the same product"), *aff'd*, 315 F.3d 101 (2d Cir. 2002); *S. Mo. Hosp. v. C.R. Bard, Inc.*, 642 F.3d 608, 615 (8th Cir. 2011) (concluding that fact that catheters were sold through Group Purchasing Organizations ("GPOs") was not sufficient to treat catheters as a "separate submarket" where GPOs provided no relevant "distribution efficiencies and advantages" that would "mak[e] the product unique and appealing to a specific class of customers"); *United States v. Dentsply Int'l*,

[4] Similarly, GameFly contends that differences in the content made available by Netflix for delivery through streaming and mail delivery suggests that streaming and physical delivery constitute different markets. GameFly Comments at 14-18. However, differences in the content offered by Netflix through different delivery channels reflects business and branding decisions by Netflix, and not limitations on the capabilities of different delivery options.

Inc., 399 F.3d 181, 188 (3d Cir. 2005) (affirming district court's determination that relevant market for artificial teeth included distribution directly to dental laboratories and through intermediary dental dealers, and rejecting argument that a relevant market "cannot include sales both to the final consumer and a middleman"); *AD/SAT, Div. of Skylight, Inc. v. Associated Press*, 181 F.3d 216, 227-29 (2d Cir. 1999) (affirming district court's determination that "the relevant product market [is] the market for delivery of advertisements to newspapers by any means"); *Westman Comm'n Co. v. Hobart Int'l, Inc.*, 796 F.2d 1216, 1220-21 (10th Cir. 1986) (rejecting the district court's narrow product-market definition where district court inappropriately "focused on the system of product distribution rather than the market facing the consumer of" the relevant products); *M.A.P. Oil Co. v. Texaco Inc.*, 691 F.2d 1303, 1308 (9th Cir. 1982) (concluding that there existed only one market for gasoline because "[c]ustomers can choose between direct delivery of gasoline and delivery through distributors or commission agents, but in the final analysis they purchase a single product—gasoline").

b. <u>Consumers consider the products offered by firms that provide access to digitized entertainment content through alternative delivery methods to be reasonably interchangeable with the mail delivery products offered by Gamefly and Netflix.</u>

GameFly's argument also disregards the preferences of consumers. Consumers view firms that provide access to digitized entertainment content through methods other than mail delivery as reasonable, and sometimes preferred, substitutes to firms that do so through the mail (such as Netflix and GameFly). Consumer behavior is a core component of market-definition, whether parties have attempted to distinguish markets on the basis of delivery methods or not. Indeed, courts frequently consider customer views on the interchangeability of the products at issue when seeking to identify relevant markets. *PepsiCo, Inc. v. Coca Cola Co.*, 315 F.3d 101, 105 (2d Cir. 2002) ("Products will be considered to be reasonably interchangeable if consumers treat them as "'acceptable substitutes.'") (quoting *FTC v. Cardinal Health*, 12 F. Supp. 2d 34, 36 (D.D.C. 1998)); *Cardinal Health*, 12 F. Supp. 2d at 46 ("[T]he relevant market consists of all of the products that the Defendants' customers view as substitutes to those supplied by the Defendants.”); *see also Fineman v. Armstrong World Indus.*, *Inc.,* 980 F.2d 171, 199 (3d Cir. 1992) (considering evidence of consumer preference for different types of floor coverings in different rooms). A district court’s failure to account for consumer behavior may even serve as grounds for vacating the court’s market definition. *See, e.g.*, *Jacobs*, 626 F.3d at 1338-39 (ruling that failure to allege sufficiently a relevant product market based in part on a failure to address “crucial” issues of consumer preference).

Evidence that consumers regard these varying methods of accessing digitized content delivery as interchangeable abounds:

Netflix’s DVD-by-mail subscriber base and revenues have fallen dramatically as streaming customer bases and revenues rise. In the quarterly period ending June 30, 2013, Netflix had 29,807,000 domestic streaming customers accounting for $671,089,000 in revenue compared to 7,508,000 domestic DVD customers accounting for $232,381,000 in revenue; during the same quarter in 2012, Netflix had 23,938,000 domestic streaming customers accounting for $532,705,000 revenue compared to 9,240,000 domestic DVD customers accounting for $291,485,000 in revenue. Netflix, Inc., Form 10-Q at 15-16 (July 25, 2013), available at http://www.sec.gov/Archives/edgar/data/1065280/000106528013000030/nflx-063013x10qxdoc.htm. Industry analysts recognize that “[a]s more devices, including gaming consoles and tablets, become compatible and effective with streaming media, they suck revenue out of [physical delivery of digitized entertainment content segment of the] industry.” IBIS World Industry Report, at 11.

Kiosk-based video-game rentals are a growing share of kiosk-based DVD rentals and are profitable. For example, RedBox has experienced an increase in revenue attributable to delivery of digitized entertainment content through its kiosks, and it has increased the number of kiosks deployed in response to growing demand.[5]

In fact, many customers purchase content from multiple providers that use different delivery technologies. For example, a family may use Netflix both to receive DVDs through the mail and to stream other content, yet it may also order videos from Amazon (which it receives either over a broadband connection or by mail) and/or rent them from a Redbox kiosk. In fact, as more households have adopted broadband and as broadband speeds have increased, an increasing number of households are moving away from renting or purchasing content from a store or kiosk or receiving it by mail, and instead have taken advantage of the greater convenience of simply streaming or downloading content from the Internet. As these trends suggest, households are effectively mixing and matching the services offered by many providers as a way of maximizing their access to content in light of their varying preferences for price, format, viewing media, convenience, etc.

c. <u>Firms that supply entertainment content through the mail similarly view other, non-mail-based services as competitors in the market for access to digitized entertainment content.</u>

GameFly's approach to market definition has been resoundingly rejected by the very firm on which it relies to make its point and the major user of the Postal Service for round-trip DVD mailing: Netflix. Netflix's understanding of its involvement in a broader market for access to digitized entertainment content is highly probative in this setting; indeed, the federal courts frequently consider industry or public perception of separate markets or submarkets in assessing the scope of the relevant market. *See, e.g.*, *FTC v. PPG Indus.*, *Inc.*, 798 F.2d 1500, 1504 (D.C. Cir. 1986) (market definition based on both buyers' and sellers' perceptions); *FTC v. Warner Commc'ns Inc.*, 742 F.2d 1156, 1163 (9th Cir. 1984) (per curiam) (record industry recognized prerecorded music as a market separate from recorded music market).

[5] Schoeman Declaration at 4.

Netflix's most recent Form 10-K submission to the U.S. Securities and Exchange Commission repeatedly emphasizes its exposure to competitors offering access to digitized entertainment content through a variety of delivery methods. For example:

> Competitors include multichannel video programming distributors ("MVPDs") with free TV Everywhere and other on demand content, Internet movie and TV content providers, including both those that provide legal and illegal (or pirated) entertainment video content, DVD rental outlets and kiosk services and entertainment video retail stores.

Netflix, Inc., Form 10-K, at 5 (Feb. 1, 2013), available at: http://www.sec.gov/Archives/edgar/data/1065280/000106528013000008/nflx1231201210kdoc.htm.

> The market for entertainment video is intensely competitive and subject to rapid change. New technologies and evolving business models for delivery of entertainment video continue to develop at a fast pace. The growth of Internet-connected devices, including TVs, computers and mobile devices has increased the consumer acceptance of Internet delivery of entertainment video. Through these new and existing distribution channels, consumers are afforded various means for consuming entertainment video. The various economic models underlying these differing means of entertainment video delivery include subscription, transactional, ad-supported and piracy-based models. All of these have the potential to capture meaningful segments of the entertainment video market. Several competitors have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, marketing and other resources than we do. They may secure better terms from suppliers, adopt more aggressive pricing and devote more resources to technology, fulfillment, and marketing.

Id.

> The market segment for online subscription-based entertainment video has grown significantly. Much of the increasing growth can be attributed to the ability of our subscribers to stream TV shows and movies on their TVs, computers and mobile devices. As we face more competition in our market segment, our rate of growth relative to overall growth in the segment may decline.

Id. at 6.

Netflix understands its continued profitability and growth to be directly implicated by the activities of firms with non-mail-based content delivery methods. Such statements strongly suggest that Netflix—and, by extension, GameFly, which has repeatedly characterized itself as a co-participant in whatever market Netflix occupies (*see, e.g.*, GameFly Comments at 5, 14 & n.2)—occupies the diverse and competitive market for access to digitized content by any and all means. Netflix's statements to this effect are particularly trustworthy given its obligations under federal securities law to supply the government—and, through the government, investors—with accurate assessments of its viability and suitability for public investment. *See* 15 U.S.C. § 78m.

d. GameFly also is subject to substantial competition.

In PRC Docket No. C2009-1, GameFly argued repeatedly that it was similarly situated to Netflix. Complaint of GameFly, Inc., PRC Docket No. C2009-1 (April 23, 2009) at ¶¶ 49, 51, 53, 55. It even persuaded the Commission to accept this argument. Order No. 718, PRC Docket No. C2009-1 (April 20, 2011) at ¶ 5002. But now GameFly's CEO contends that GameFly operates in a video game market separate from the filmed entertainment market in which Netflix operates. GameFly Comments at A-2. Regardless of whether Netflix and GameFly are similarly situated, or compete in the same "market," as described below, there are numerous alternative methods of delivering video game content that compete with the Postal Service's mail delivery.

Netflix and GameFly are not the only firms that deliver digitized content through the mail. Amazon, in particular, operates as a clear competitor in the mail delivery of DVDs: Amazon sells both video and video game DVDs and relies on UPS to fulfill customer orders. Likewise, GameFly's status as a vendor of video game DVDs—as distinguished from video DVDs—confers on it no special protection from competition. Crucially, GameFly faces competition from all angles for shares of the market for digitized video games. As previously related, Redbox currently operates a kiosk-based video game DVD rental business that is profitable and growing. Meanwhile, Amazon and other Internet-based vendors sell games—both new and used—that can be delivered through the mail.

There is also an increasing interest among consumers in accessing video games through streaming channels. The marketplace is already populated by several services that permit consumers to stream games to multiple sources, such as TVs, PCs, tablets, and mobile devices. Steam is the largest digital distributor of video game content, and offer time-limited video game rental services.[6] Other services include OnLive, CiiNow, and GaiKai, the last of which is owned by Sony Computer Entertainment, which manufacturers the popular Playstation line of video game consoles. Expert Decl. at 4. Publications monitoring the video game industry expect the trend toward streaming and downloading to continue into the future, particularly as consumers come to expect regular updates of games. Expert Decl. at 7.

Finally, with the explosive growth of smartphone and tablet computer technology, firms such as GameFly that rent and/or sell console games compete with the makers and vendors of comparatively inexpensive smartphone apps for the attention and money of gamers.

e. Federal antitrust law rejects GameFly's attempts to define its relevant market in terms of the Postal Service's specialty.

In defining the relevant market as the delivery of DVDs through the mail, GameFly has, for all intents and purposes, alleged that the Postal Service enjoys a monopoly over the mail—the Postal Service's own product— even where the Private Express Statutes are inapplicable. GameFly Comments at 9. The Supreme Court has determined, however, that firms should ordinarily not be deemed to have "monopolized" their own products. *See United States v. E.I. DuPont de Nemours & Co.*, 351 U.S. 377, 393 (1956); *see also, e.g.*, *PSKS, Inc. v. Leegin Creative Leather Prods.*, 615 F.3d 412, 418 (5th Cir. 2010) (explaining that "a single brand of a product or service can constitute a relevant market for antitrust purposes only in "situations in which consumers are 'locked in' to a specific brand by the nature of the product"); *Green*

[6] Schoeman Declaration at 4, 8, 12-13.

Country Food Market, Inc. v. Bottling Group, 371 F.3d 1275, 1282 (10th Cir. 2004) ("In general, a manufacturer's own products do not themselves comprise a relevant product market . . . . [A] company does not violate the Sherman Act by virtue of the natural monopoly it holds over its own product."); *Tanaka v. Univ. of S. Cal.*, 252 F.3d 1059, 1065 (9th Cir. 2001) ("[b]y attempting to restrict the relevant market to a single athletic program in Los Angeles based solely on her own preferences, [plaintiff] has failed to identify a relevant market for antitrust purposes"); *Hack v. President & Fellows of Yale College*, 237 F.3d 81, 86 (2d Cir. 2000), *abrogated on other grounds by Swierkiewicz v. Sorema N.A.*, 534 U.S. 506 (2002).

Citing the low elasticity of demand for first-class mail, GameFly suggests that it would be profitable for the Postal Service to raise prices and then notes that "the ability to increase profits through a small but significant non-transitory increase in price (SNIPP) [sic] is a well-accepted test of market power." GameFly Comments at 12. GameFly misconstrues the function of the SSNIP test and fails to recognize that it cannot be applied here. The SSNIP test was introduced in the 1992 *DOJ/FTC Horizontal Merger Guidelines*. U.S. Dep't of Justice & Fed. Trade Comm'n, HORIZONTAL MERGER GUIDELINES (1992), available at http://www.justice.gov/atr/public/guidelines/hmg.pdf. In those *Guidelines,* the antitrust agencies described the SSNIP test (also known as the "Hypothetical Monopolist" test) as follows:

> [T]he Agency will delineate the product market to be a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ("monopolist") likely would impose at least a "small but significant and nontransitory" increase in price.

Id. at 6.

The SSNIP thus is a method for defining relevant markets, not identifying market power. But it cannot be used for market definition here due to the specific facts of the case. As Professor Carlton explains, while the current market price can be used as the benchmark in evaluating mergers, when evaluating market power, one must use the "competitive price." Dennis W. Carlton, *Market Definition: Use and Abuse,* 3 COMPETITION POL. INT'L 3, 19 (2007).

But in this case the current price is regulated, such that we cannot assume that it is equal to the competitive price. Thus, even if the Postal Service could raise the price of return-mail DVD mailers, its ability to do so would not support the inference that it occupied a separate product market for antitrust purposes.

3. Methods of providing digitized content are changing rapidly.

The market for access to digitized entertainment content is a dynamic one where market shares and delivery techniques change rapidly. Delivery of DVDs through the mail has been declining in recent years and losing share to other forms of delivery. Since FY 2010, Netflix's yearly mailings have dropped by 58%. Monteith Declaration, at ¶3. The Postal Service's most recent estimates suggest that Netflix's mailings will further decline in Financial Year 2014. *Netflix-GameFly Totals-Forecasts FY110FY14_080213_v2.xls (Filed on August 5, 2013 as part of USPS-MC2013-57/NP1).*. Similarly, GameFly's mailings have steadily declined and are projected to continue to do so in upcoming years. Since FY 2011, GameFly's volume has decline by 29%. Monteith Declaration, at ¶3. The Postal Service projects that GameFly's FY 2014 volume will drop continue to decline. *Netflix-GameFly Totals-Forecasts FY110FY14_080213_v2.xls (Filed on August 5, 2013 as part of USPS-MC2013-57/NP1).* These declining mail volumes speak to changing consumer preferences (which increasingly favor access via the Internet over mail-delivery) and substantial inroads made by competitors using non-mail delivery systems. Under these circumstances, neither GameFly, nor Netflix possesses the power to significantly raise and profitably maintain prices above competitive levels.

This, in turn, has important implications for the Postal Service. Just as Netflix and GameFly must compete against companies using alternative delivery methods, the Postal Service must compete against those alternative delivery methods, with the result that it is not market dominant for statutory purposes. As discussed above, providers of access to digitized entertainment content that use the mail must compete against providers using a variety of other delivery methods. Moreover, providers' preferences for various delivery methods will vary over time, both as the relative costs of those alternative delivery methods vary and as consumer preferences evolve. Under the conditions described above, the Postal Service's pricing power with respect to its round-trip DVD mailer product is limited by the availability of alternative, less expensive, faster, and more convenient delivery methods.

Netflix and GameFly face growing competitive pressure on their mail-delivered products, as evidenced by the rapid drop in their volume of shipments. If the Postal Service were to attempt to raise its rates for round-trip DVD mailing and if GameFly and Netflix were to attempt to pass part or all of that cost increase onto consumers (which economic theory suggests they would), the current decline in demand could accelerate, which would reduce profits not only for GameFly and Netflix, but also for the Postal Service. *See* IBIS World Report at 4. Moreover, if the Postal Service were to attempt to raise its price, it would increase the risk that Netflix or GameFly or both might abandon mail delivery in favor of cheaper and more popular alternatives for providing access to consumers.[7] Under these circumstances, the Postal Service is no more able to exercise market power over DVD-mailing products than GameFly and Netflix are able to exercise market power over the access to digitized content they supply to consumers. Consequently, the Postal Service cannot properly be said to be able to set the "price of [of its DVD mailing] product[s] substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products." 39 U.S.C. § 3642(b)(1). And, thus, the Postal Service is not market-dominant with respect to its DVD-mailing products.

[7] The fact that Netflix currently derives far more revenue from streaming than from mail-delivered videos highlights this danger. *See* Expert Decl. at 2. And as recognized by industry analysts, the "[digitized entertainment content] industry is expected to phase out direct-mail services during the next five years as mailing costs continue to increase and the majority of consumers switch to streaming or on-demand services." IBIS World Report at 8.

B. GameFly Seeks Special Treatment that Is Potentially Unsustainable and Certainly Unwarranted under Existing and Emergent Market Conditions.

This section explains why the price structure sought by GameFly is inappropriate. First, market conditions do not support classification of the Round-Trip Mailer as market-dominant. Second, classification of the Round-Trip Mailer as "competitive" will not threaten GameFly's viability as a business. And finally, classification of the Round-Trip Mailer as "market-dominant" has the potential to cause significant harm for the Postal Service.

1. Current and expected future market conditions do not support classification of the Round-Trip Mailer as a "market-dominant" product.

GameFly represents one method for delivering content in a market that currently features a wide variety of such methods and, in the future, may feature even more. The body of viable methods is expanding and changing in response to evolving technological capacities and complicated and constantly shifting consumer preferences. Indeed, few areas of economic activity better embody the process of creative destruction that drives innovation and promotes consumer welfare. The more the Postal Service's regulated rates insulate GameFly from the true costs of its service, the less incentive GameFly has to innovate. Requiring input prices to be set below competitive levels sends the wrong signals to providers of access to digitized entertainment content and to consumers of it. And it will tend to delay the development and adoption of new and cheaper delivery methods.

The data make clear that consumers are rapidly turning to providers of digital entertainment content that deliver it by means other than the mail (and particularly via streaming over the Internet). As previously explained, these changing consumer preferences create a strong constraint on the ability of Netflix or GameFly to raise prices for content delivered by mail.

If DVD mailers were reclassified as competitive, the Postal Service could negotiate commercial agreements with Netflix and GameFly, two large and powerful purchasers with considerable bargaining power. The negotiations could adjust for cost, as those costs may change depending upon the mix and volumes of products. Across market contexts, the ability of "power buyers" to push back against price increases has been recognized to mitigate the effects of any large market share and will similarly limit the Postal Service's ability to raise prices here. And the competitiveness of the downstream market for access to digitized entertainment content will constrain the size of any price increase to consumer. If the Postal Service sought to charge too much and GameFly and Netflix passed these costs on to consumers, demand would drop to such an extent that profits would drop for both GameFly and Netflix, on the one hand, and for the Postal Service, on the other. Alternatively, Netflix and GameFly may decide to simply shift to newer and more popular delivery methods. In either case, the Postal Service would suffer losses. The potential for such losses would constrain the range within which Netflix and GameFly on the one hand and the Postal Service on the other would bargain to determine new prices. Given these pressures, it appears likely that the Postal Service would have a strong incentive to negotiate a price that covered its costs but did not contribute to a further drop in demand.

2. Reclassifying DVD-mailers as "competitive" will not threaten GameFly's viability.

If these round-trip DVD mailer products are reclassified, the Postal Service will certainly seek to negotiate a price that covers its costs, but it would not be in the Postal Service's interest to charge a supra-competitive price, since this would accelerate the decline in demand. And it certainly would not be in the Postal Service's interest to charge a price that might threaten GameFly's viability, since this would this would result is total elimination of demand. GameFly's protestations that current (remaining) demand for first-class mail is purportedly "inelastic" are not to the contrary. GameFly Comments at 11-14. The only evidence that GameFly cites in support of this claim is a Postal Service study that found that the demand for first-class mail generally was inelastic. It may be true that the present demand for First-Class Mail—as a general, broad class of mail—is inelastic. *See* Bozzo, A. Thomas, Kristen L. Capogrossi, B.

Kelly Eakin, John Pickett and Mithuna Srinivasan, "Is Demand for Market Dominant Products of the United States Postal Service Becoming More Own Price Elastic?" (May 30, 2013) at 6. But even if that is true there are certainly at least sub-classes of mail within that broad class with more or less price elasticity. *Id.* at 7.

The Postal Service recognizes that technological change and changing consumer preferences could lead eventually to the demise of mail delivery of DVD (IBIS Report at 8), and it is not in its interest to accelerate that delay or hasten any such demise. Furthermore, any argument GameFly might raise as to the alleged "inelasticity" of its own market is flawed for the same reasons its proffered definition of the relevant market is flawed: GameFly attempts to stack the deck in its favor by defining the relevant market in terms of its existing business model of delivering DVDs by mail. Certainly, in the short term, GameFly may find it difficult simply to abandon mail delivery. But, it *can* shift its business model over the medium- and long-term. Indeed, despite GameFly's claims that delivery by mail is the only way to distribute DVDs economically (GameFly Comments at 23-29), kiosk-based rentals are rising in market share and are currently profitable. Expert Decl. at 3; Outerwall. Even more important is that web-based game delivery has *already* emerged as a viable alternative: two of three major console makers have announced that their upcoming consoles will feature full Twitch-compatibility. Schoeman Declaration. GameFly is no more trapped with its existing model than it is a monopolist in the field for delivering access to digitized electronic content.

3. Classification of the Round-Trip Mailer as a "market-dominant" product could have severe negative consequences for the Postal Service.

Adoption of GameFly's argument regarding the Postal Service's position in the relevant market applicable to these dockets could cause significant harm to the Postal Service. As explained in the Declaration of Virginia Mayes, the Round-Trip Mailer product has experienced a decline in volume that is expected to accelerate in the future. This decline in volume leads to an increase in unit costs.[8] If the Round-Trip Mailer product is classified as “market-dominant,” the Postal Service would be forced to apply part of its price cap authority to the Round-Trip Mailer to avoid losses as the unit costs increase as a result of volume declines.[9] Application of price cap authority to a product with declining volume would prevent the Postal Service from applying price cap authority to growing products, leading to inefficient business decisions and restricting the Postal Service’s ability to increase revenue.[10] This problem can be avoided by classifying the Round-Trip Mailer product as “competitive.”

III. THE COMMISSION MUST CONSIDER THE COST ESTIMATES IN NONPUBLIC LIBRARY REFERENCE USPS-MC2013-57/NP1.

In its Comments, GameFly argues that estimates of attributable costs of handling DVD mail should be given no weight because: 1) round-trip DVD mail faces too little competition; 2) costs for letter-shaped and flat-shaped DVD mail are precluded by Commission Order No 1763; 3) GameFly has not had enough opportunity to subject the data to discovery or cross-examination; and 4) as described in the Declaration of Sander Glick, the costs estimates overstate the actual costs of handling DVD mail. Comments of GameFly, at 31-32. These arguments are not only unfounded, but appear to misconstrue the very nature of the current proceedings.

First, as demonstrated in the preceding paragraph, round-trip DVD mail faces a number of competitors in the digital video and gaming market. Consequently, the costs estimates can be appropriately considered by the Commission under 39 U.S.C. § 3642(b) and 36339(a). Second, GameFly states that the Postal Service’s cost estimates cannot be considered because

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8 Mayes Declaration at ¶ 26.
9 *Id.* at ¶¶ 28-29.
10 *Id.*

differences in letter-shape and flat-shape DVD mail "cannot be relied upon to preclude complete relief from the undue discrimination the Commission has found to exist." Order No. 1763, at 32 (quoting GameFly, Inc. v. PRC, 704 F.3d 154, 148-49 (D.C. Cir. 2013)). This argument is a non sequitur. Indeed, in Order No. 1764 the Commission gave the Postal Service the option of eliminating the discrimination it found by "establish[ing] equalized rates for both letter-shaped and flat-shaped DVD mail." *Id*. at 39. Here, the Postal Service has proposed exactly such a solution and requested that the resulting product be classified as Competitive, in accordance with the requirements of 39 U.S.C. § 3642. Thus, rather than being an attempt to preclude relief from the discrimination found by the Commission, the Postal Service properly submitted its cost estimates in accordance with sections 3642(b) and 3633(a), and Order No. 1794. Order No. 1794, at 5.

With respect to the third argument, GameFly misconstrues that nature of the current proceeding, which is conducted pursuant to 39 C.F.R. 3020.33 and 3020.34. Under these rules, parties are not entitled to the extensive discovery that GameFly claims to be necessary, but instead provides for a "specified period for public comment." 39 C.F.R. § 3020.33(e). Here, the Commission appropriately prescribed a period of ten days for public comment and GameFly received timely access to the Postal Service's nonpublic cost estimates in accordance with Commission Order No. 1801. See Oder No 1794, at 5 (July 30, 2013); Order No. 1801, at 3 (August 8, 2013). Moreover, if as GameFly claims, more time was needed to review the Postal Service's cost estimates, it is worth pointing out that it never filed such a request with the Commission.

Finally, with respect to the critiques of the cost model offered by GameFly in the Declaration of Sander Glick, the Postal Service offers the Declarations of Virginia J. Mayes (Attachment B) and Thomas Bozzo (Attachment C) in response. As discussed in these declarations, Mr. Glick's critiques are either unsupported, mistaken, or both, and should be given no weight by the Commission.

IV. THE COMMISSION'S STATEMENTS IN ORDER NO. 1807 HAVE NO BEARING ON THE CURRENT PROCEEDING.

In their comments, both Netflix and GameFly argue that the statements made by the Commission in Order No. 1807, concerning the application of its price-cap rules to the equalized rate remedy prescribed in Order No. 1763, make the current proceeding unnecessary. Netflix Comments, at 3, GameFly Comments, at 30-31.[11] Both parties appear to imply that because the Commission opined on the application of its price cap rules to the equalized rate remedy, the Postal Service's choice to propose the Round-Trip Mailer product is somehow mooted out. This argument is without merit.

In Order No. 1764 the Commission gave the Postal Service the option of eliminating the discrimination it found by "establish[ing] equalized rates for both letter-shaped and flat-shaped DVD mail." Order No. 1764, at 39. In its Request, filed on July 26, 2013, the Postal Service proposed exactly such a remedy and asked that the resulting product be classified on the competitive side. Request, at 3. At that time the Postal Service also noted that after considering the Commission's remedies in Order No. 1763, it concluded that "the most natural fit for [the Round-Trip Mailer] product is on the Competitive side." The Postal Service's position has not changed. Since Order No. 1807 does not require that the Postal Service's Request be withdrawn, and since Netflix and GameFly have not asserted a legal bases for requiring such a withdrawal, the Commission should properly review the proposed Round-Trip Mailer product in accordance with 39 U.S.C. § 3642.

[11] In Order 1807 (Order on Reconsideration and Clarification – August 13, 2013) the Commission stated that the Postal Service could have avoided a price-cap calculation by treating the equalized rates for DVD mail like a mid-year price decrease. Order No. 1807, at 9-10. If the decrease is continued into a future year, the Postal Service could incorporate the reduced price into its cap calculation at that time. *Id*.

Conclusion

For the reasons stated above, the Commission should approve the Postal Service's 3642 filing.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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ATTACHMENT A

BEFORE THE

POSTAL REGULATORY COMMISSION

WASHINGTON, D.C. 20268-0001

COMPETITIVE PRODUCT LIST ADDING ROUND-TRIP MAILER	)))	MC2013-57
COMPETITIVE PRODUCT LIST ADDING ROUND-TRIP MAILER	)))	CP2013-75

DECLARATION OF MARK SCHOEMAN

Biographical Sketch

My name is Mark S. Schoeman. I am President of The Colography Group, Inc., located at 47 Perimeter Center East, Suite 600, Atlanta, Georgia 30346. I have held my present position since 2010. Prior to becoming President, I served as the Vice President of Dedicated Research Services from 1997 to 2010. Before joining Colography, I worked for the United Parcel Service in various capacities including contract pricing, business development, new product group and National Accounts.

I submit this declaration in response to the comments of Netflix and GameFly and the accompanying Declaration of David Hodess in this docket regarding the Postal Service's July 26 "Request Under Section 3642 to Create Round-Trip Mailer Product."

The Colography Group

The Colography Group was established in 1983 and is located in Atlanta, Georgia. The Colography Group is a market research consultancy that specializes in the expedited package transportation market - the movement of goods and services via mail, package or freight services both in the United States and globally. The firm is built around three primary components of the shipping business: the cost of transportation services, the logistics of transportation, and the geography of shipping demand. Today, The Colography Group conducts ongoing quantitative empirical research on shipping establishments all over the world to ascertain the shipping and mail market and trends across industries.

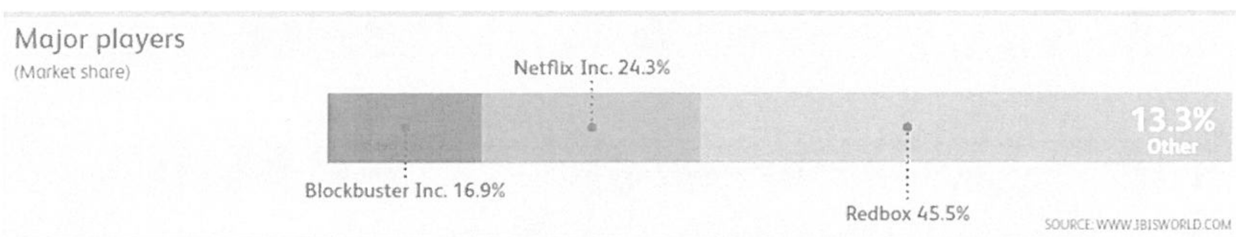
Overview

The digitized entertainment industry includes movies and games distributed to consumers through multiple delivery channels. These channels are physical delivery by mail, streaming, online downloads, the cloud, kiosks, and retail outlets. Therefore, the physical distribution of movies and games competes with streaming, downloads, the cloud and kiosks.

Digital Entertainment Industry Service Providers

The digital entertainment industry has many service providers.

IBISWorld recently reported[1] the market share of the major service providers of physical media rentals of movies and games as follows:



The business results for 2012 for the digital entertainment service providers for which there is publically available data are shown below.

Netflix

Netflix 2012 Form 10-K at 22 shows the following business results:

[1] IBISWorld Industry Report 53223 DVD, Game & Video Rental in the US (June 2013) at 21.

Netflix As Of Year Ended December 31			Change
	2012	2011	2012 vs. 2011
	(in thousands, except percentages)		
Subscriptions:			
Domestic Streaming			
Net additions	5,475		n/a
Paid subscriptions at end of period	27,146	21,671	25%
Domestic DVD			
Net losses	-2941		n/a
Paid subscriptions at end of period	8,049	11,039	27%
Subscribers:			
Unique Domestic			
Net Additional	4,973	4,894	2%
Paid subscribers at end of period	27,613	22,858	21%
Contribution Profit			
Domestic Streaming Revenues	2,184,868		n/a
Domestic DVD Revenues	1,136,872		n/a
Total Domestic Revenues	3,321,740	3,121,727	6%

In 2012, Netflix's total domestic revenues were more than $3.3 billion. About 34 percent of its revenue contribution was from DVD mailings and 66 percent were from streaming. In 2012, it had over 27.1 million paid subscribers for streaming, an increase of 4.7 million from 2011, and over 8 million paid subscribers for DVD, a decrease of 2.9 million from 2011. Netflix Form 10-K (Feb 1, 2013) at 22. Since 2010, Netflix has more users viewing content via streaming over the Internet than on DVD.[2] Of all Netflix subscribers, 42 percent use their computers to stream and watch, while 14 percent watch by connecting their computer to the TV.[3] Netflix reports in its 2012 Form 10-K at 1 that its core strategy is to grow its streaming business.

Outerwall (RedBox)

RedBox distributes DVD movies and games at kiosks and offers online streaming through RedBox Instant, a joint venture with Verizon launched in 2013.[4] RedBox sees its competition as coming from subscription mail order providers and brick-and-mortar retail stores. Its revenues from kiosks are growing and the number of kiosks deployed has increased to serve the growing demand. As of June 2013, Redbox had over 43,700 kiosks in 35,800 locations. IBISWorld *Industry Report 53223 DVD, Game & Video Rental in the US* (June 2013) at 21.

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[2] http://readwrite.com/2010/11/21/we_really_dont_need_no_stinkin_dvds_netflix_introd#awesm=~of0PNmmr0goFS5

[3] http://www.statisticbrain.com/netflix-statistics

[4] http://news.cnet.com/8301-1023_3-57574480-93/redbox-instant-launches-video-streaming-to-the-public/

DISH Network (Blockbuster)

DISH 2012 revenues were $14.3 billion, $1.2 billion of which was Blockbuster's revenue. Blockbuster distributes movies through mail order, kiosks, stores and Blockbuster@Home, which offers streaming to subscribers of DISH. DISH Network Corporation Form 10-K (2012) at 2.

GameStop

GameStop, the United States' largest used-games retailer, experienced a used-game revenue jump of $1.8 billion in 2011. IBISWorld *Industry Report NN003 Video Games in the US* (June 2013) at 7. GameStop's 2012 total revenue was $8.9 billion. Primarily a brick-and-mortar business, GameStop also offers digital downloads both online and in-store.

GameStop's strategic goal is "to continue to be the world's largest multichannel retailer of new and used video game products and PC entertainment software and expand [the] business into the mobile device category to provide the best video game content to [its] customers anytime, anywhere and on any device." Form 10-K (February 2, 2013) at 4. In 2010, GameStop purchased Kongregate Inc., the operator of online video gaming site www.kongregate.com, which offers free-to-play video games to over 15 million unique visitors per month. It also purchased the PC distribution platform, Impulse, and streaming technology company, Spawn Labs, in 2011. Streaming will be focused on tablets, smart TVs and PCs. GameStop Form 10-K (February 2, 2013) at 12. Digital receipts in 2012 were $630 million, up from $180 million in 2009. GameStop Form 10-K (February 2, 2013) at 6.

Game Rental Services

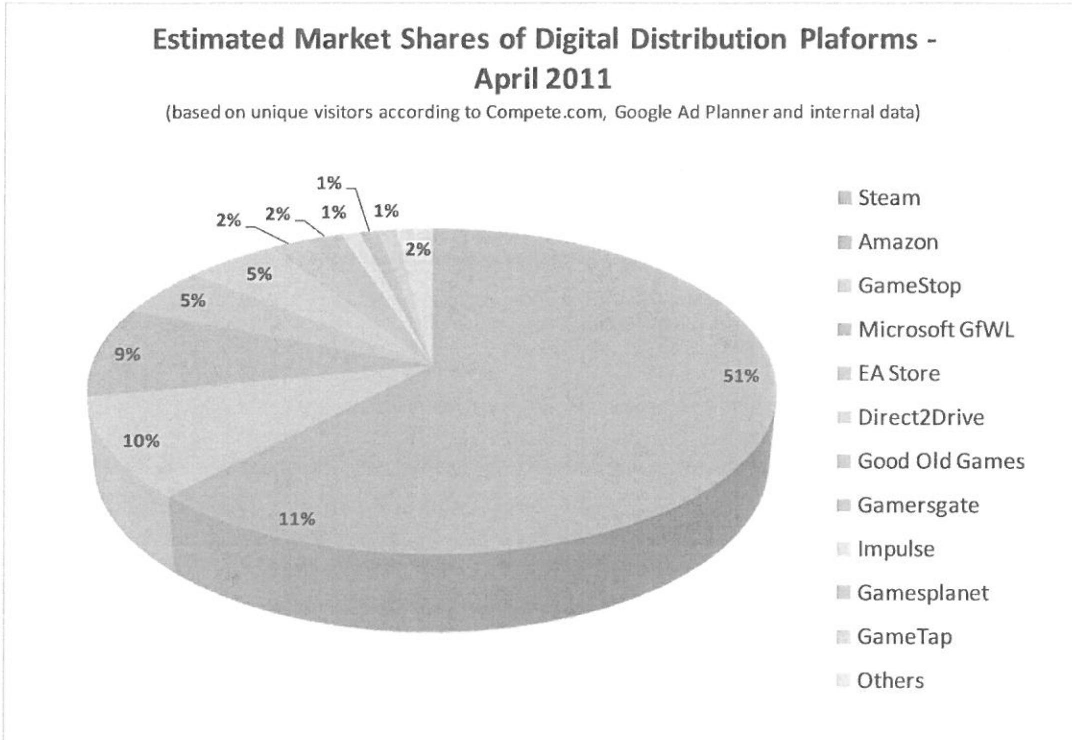
There are two primary video game rental services by mail - GameFly and Gamerang. Both are privately held companies for which business results are not publicly available.

Download Services

There are several gaming download services or digital distributors. They include:

- Steam PC: the biggest with 55% market share
- Amazon: 11% market share
- GameStop, which now owns Impulse: 10% market share
- Microsoft Games for Windows Live: 9% market share
- Electronic Arts Store (now Origins): 5% market share
- Direct2Drive (GameFly): 5% market share
- Additional smaller players make up the remaining market share shown in the chart below

ATTACHMENT A



Source: http://www.gamasutra.com/blogs/SebastianLindig/20110606/89588/Market_Share_for_PC_Digital_Distribution_Platforms_2011_based_on_unique_users.php

Cloud/Streaming Services

There are growing Cloud Gaming/Streaming/Games-On-Demand Services that eliminate the need for consumers to buy gaming consoles and/or buy or rent game discs. These services provide streaming games to multiple sources – TV, PC, tablet, mobile devices, etc. These providers include:

- OnLive
- GaiKai
- CiiNow

OnLive and CiiNow are privately held companies for which business growth and key financial data is not publicly available. GaiKai is owned by Sony Computer Entertainment. Business results specifically related to GaiKai are not publicly available.

Distribution of Digital Entertainment is Shifting from Physical to Digital

Netflix asserts that the "…fact that multiple media forms deliver video content is not sufficient to render them all part of a single product market. The question is whether different media are substitutable...In that regard, there are significant differences between physical DVD and Internet-delivered services which suggest that they may not be substitutable." (Netflix Comments at 7-8). We and industry analysts see that there is a great deal of competition and substitutability between each of the distribution channels of digital entertainment.

Movies

IBISWorld has found that streaming movies "… is a major substitute for physical media rentals." IBISWorld *Industry Report 53223 DVD, Game & Video Rental in the US (*June 2013) at 11. In our view, there is an undeniable shift in the digital entertainment market from physical to digital. "A slew of alternative media is causing consumers to cease renting physical copies of videos and games. Instead Americans are choosing streaming media, video on demand and online downloads." IBISWorld *Industry Report 53223 DVD, Game & Video Rental in the US* (June 2013) at 4.

For rented video content, the competing distribution channels are mail, downloads, streaming, brick-and-mortar stores and kiosks. IBISWorld has found that "physical media competes with new high-definition movie formats available on digital cable and satellite TV, as well as general digital broadcast TV. Competitive advantages of these rivals include the use of digital video recorder (DVRs) that enable households to record, pause, rewind and fast-forward films and programs by using an internal hard drive in the TV or a set-top box linked to program distributors." IBISWorld *Industry Report 53223 DVD, Game & Video Rental in the US* (June 2013) at 6.

RedBox sees its kiosk rental service as competing with online and mail providers of movies and brick-and-mortar stores. In quarter 2 of 2013, RedBox reported that its market share for DVD movies rented was growing in comparison with these other distribution channels:

	Online/By Mail Provider	National Brick & Mortar Retail Chains (includes.com)	All Other Brick & Motar (includes Local)	RedBox
Share	25.30%	12.80%	9.80%	50.60%
Change	-1.90%	-3.40%	-0.90%	5.80%

Source: Outerwall, 2013 Q2 Prepared Remarks Slides, July 25, 2013, slide 6.

The substitutability and competition between physical delivery and streaming of rental movies is further shown by the fact that RedBox and Netflix offer streaming service. RedBox introduced a streaming product in 2012. Netflix has about two-thirds of total streaming market share in the US.[5]

According to IBISWorld[6], the DVD, Game & Video Rentals market in the United States is estimated to have declined at a five year annualized rate of 13.7 percent to $4.5 billion in revenue in 2013. As a result of the shift to digital consumption, IBISWorld projects a 21.2 percent annualized decline in revenue to $1.4 billion in the five years

[5] http://news.cnet.com/8301-1023_3-57584535-93/video-streaming-is-on-the-rise-with-netflix-dominating
[6] IBISWorld Industry Report 53223 DVD, Game & Video Rental in the US, June 2013 at 4, 8.

from 2013 to 2018. It projects that the availability of the Internet and broadband connections will continue to grow, leading consumers to switch to streaming and downloaded media.[7]

In March 2011, a PwC study found that while 43 percent of Americans still rented discs though the mail, 32 percent preferred streaming through a subscription. The preferred methods for renting included a la carte streaming, DVD kiosks, and video stores. IBISWorld *Industry Report 53223 DVD, Game & Video Rental in the US* (May 2011) at 6.

IBISWorld projects DVD rentals will decline 4.6 percent in 2013 "... as consumers continue to switch from rent-by-mail to online streaming." IBISWorld *Industry Report 53223 DVD, Game & Video Rental in the US* (June 2013) at 23. In other words, physical rentals are experiencing a downward trend while digital revenue is growing because more and more customers prefer streaming and other forms of digital distribution. IBISWorld says "the industry is expected to phase out direct-mail services during the next five years as mailing costs continue to increase and the majority of consumers switch to streaming or on-demand services." IBISWorld *Industry Report 53223 DVD, Game & Video Rental in the US* (June 2013) at 8. Thus, as IBISWorld states, streaming movies over the Internet is "a major substitute for physical media rentals." IBISWorld *Industry Report 53223 DVD, Game & Video Rental in the US* (June 2013) at 8,11.

For Netflix, the rapid decrease in subscribers to DVD by mail coupled with the increase in subscribers to streaming clearly demonstrates the substitutability of the products. As shown in its 2012 annual report, Netflix had over 27 million paid subscribers to its US streaming business and 8 million subscribers to their US DVD business. Furthermore, over the last few years the number of streaming subscribers has increased while the number of DVD customers declined. Streaming, the cloud, online downloads, and on-demand services are the next iteration of digital entertainment products. For Netflix, streaming is an effective model for delivering entertainment. Streaming delivers content over the Internet to numerous devices including consoles, computers, Smart TVs, mobile devices, Blue-ray players, Internet video players such as Roku and Apple TV, and more.[8]

Games

The same is true for games. According to a 2013 report by the Entertainment Software Association, "Essential Facts About the Computer and Video Game Industry," at 11, digital sales of video games have increased from 20% in 2009 to 40 percent in 2012 while physical sales have decreased from 80% to 60%.

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[7] Ibid.

[8] Netflix, Inc. Form 10-K (February 10, 2012) at 2.

This shift toward digital is apparent to The NPD Group, who reported that "2012 marked the end of the video game industry as primarily a business of physical goods." [9] In an interview with Gamespot, The NPD Group analyst Liam Callahan states, "When including all other forms of content spending outside of new physical games, the 2012 U.S. games market was more than twice as large as the total spending on new physical games alone. There were divergent trends when looking at content spending in 2012 as a whole, with a decrease of 21 percent in spending on physical content while digital content spending grew 16 percent; both formats combined for a total decline of 9 percent for the year."[10]

GameFly asserts that the downloading of video games is not a viable competitive alternative to the distribution of rental games by DVD, and it is unlikely to become a viable competitive alternative for the foreseeable future. GameFly Comments at 26-28, quoting Mr. Hodess' Declaration at A-13. Industry analysts of the gaming industry have said that digital distribution represents the present and future for delivery of digitized entertainment content. IBISWorld reported "…publishers are increasingly turning to downloadable content (DLC) to supplement their games. Especially for AAA releases, publishers will develop additional content for games, such as additional maps, single-player missions or multiplayer modes, to be sold straight to gamers for a small fee. Publishers offer DLC typically over the game's website (for PCs) or console online markets (such as the Xbox Live Arcade for Xbox 360 or the PlayStation Network for the PS3). Similarly, online distribution platforms for PCs, namely Steam from Valve Software and Origin from Electronic Arts, allow consumers to purchase full games on their release date for download straight to their PCs. Publishers have embraced DLC because it forgoes the cost of physical media production, distribution and retailing." IBISWorld *Industry Report 53223 Video Games in the US* (June 2013) at 8. IBISWorld's June 2013 report also states "…While game sales and development and new consoles are still going strong, the real story of industry growth is the move of gamers online. Competitive and co-operative gaming are simpler when used in an online format, and there are more options for gamers such as expansion pack downloads for existing games, and online universes that are growing in popularity, notably *World of Warcraft*." IBISWorld *Industry Report 53223 Video Games in the US* (June 2013) at 17.

IBISWorld reported that digital entertainment companies are switching from physical distribution to digital because technology has led to greater efficiency and better service. These service providers can practically eliminate the cost of distribution and drastically reduce costs of capital and depreciation expenses through reduced inventory. They can also provide a higher level of convenience for consumers with no

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[9] http://www.digitaltrends.com/gaming/npd-group-us-game-market-total-14-8-billion-in-2012-as-digital-distribution-grows-and-physical-game-sales-fall
[10] http://www.gamespot.com/news/npd-1408-billion-spent-in-us-on-games-in-2012-6403470

rental time limits, no late fees and a product that is immediately available. As streaming technology continues to be improved upon, the trend away from mail service will only continue. IBISWorld Industry Report 53223 *DVD, Game & Video Rental in the US* (June 2013)at 4, 8, 18, 24.

In addition to digital distribution, digital downloading and streaming of game updates are an emerging trend. Gaming website GameSpot predicts that with each new generation of consoles, these trends will become even more apparent, and games as a static unit will transition to games as a platform.[11] There is a growing expectation that games will be regularly updated with content, a trend that will certainly aid the growth of digital distribution.[12]

Clouding gaming is another form of digital distribution. "Cloud gaming is having a big impact in the on-demand and downloadable content distribution world. Valve is a good example of how downloads are shaking up the power of traditional publishers like Electronic Arts and Activision; any company can now get their game into users hands through a marketplace or directly through their own website. This has led to a resurgence in indie gaming that is injecting some welcome variety into the industry."[13]

The Cloud offers many benefits to players. It has virtually unlimited memory and will not lose players data when they forget to save, nor do players have to worry about losing the disc. They can re-download games at any time and on numerous devices.[14]

Digital Entertainment Service Providers Have Recognized and Embraced the Trend to Digital Distribution

The service providers of digital entertainment have clearly recognized the shift toward digital media and have taken steps to remain relevant to their consumers. Netflix has grown its streaming business. RedBox, who has been extremely successful with its kiosk business by putting DVD rental movies at the fingertips of consumers while shopping, recently launched RedBox Instant, allowing consumers to stream on numerous devices. Blockbuster now offers Blockbuster@Home, a streaming service for DISH subscribers. GameStop has also begun to adapt by purchasing online gaming site Kongregate.com, PC distribution platform Impulse, and a streaming technology company Spawn Labs. [15] These businesses have chosen to adapt to changing consumer preferences and technology in order to compete in the market. Others have fully embraced this change, including digital distribution and communication platform Steam PC and Cloud gaming companies GaiKai, OnLive, and CiiNow. While GameFly

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[11] http://www.internap.com/industry-news/video-game-industry-trends-point-to-importance-of-data-center-hosting
[12] Ibid.
[13] http://popcultureatemymonkey.com/2013/03/24/guest-post-cloud-gaming-changing-the-way-you-game
[14] Ibid.
[15] GameStop, Corp. Form 10-K (February 2, 2013) at 12

has not entered the business of streaming console games over the Internet and does not plan to do so (GameFly Comments at 25), it has adapted to this trend by purchasing the gaming download service Direct2Drive in 2011.[16]

Downloading Video Game Market

Mr. Hodess states that "one of the main attributes of console video gaming is the ability to play on a large television monitor using console game controllers." Hodess Declaration at A-8.

The video game market encompasses much more than consoles. It is rapidly advancing away from using discs to provide content in favor of digital steaming and downloading. In addition, video games are currently available for download to televisions. Panasonic has numerous video games available for download to televisions through their VIERA program.[17] There are only 42 games on the site. Is this the best example? Most video game users today do not use "large television monitor[s]" with powerful PCs and specialized wireless controllers to play video games.[18] If the user chooses to play a PC based video game, they will generally play the game on a PC (source?). PCs are often more powerful than consoles, able to render better quality graphics and more frames per second.[19] PC games are made for use with a mouse and keyboard, though many controllers are compatible. If the user chooses to play the game on a television, they use a specialized video game console, such as a Microsoft Xbox 360, Sony PlayStation or Nintendo Wii.[20]

These video game consoles currently support downloadable games.[21] Consumers can search electronic marketplaces using their console to find games and download them to the device. For example, Xbox currently utilizes the Xbox Live Marketplace to make available downloadable games, music, videos, apps and game demos.[22] In fact, Xbox Live Marketplace's Games on Demand currently has hundreds of downloadable games.[23] The games released for download on consoles are exactly the same as games released on discs for consoles, and also may include or can by supplemented by downloadable content for games that would not otherwise be available without using the digital marketplace.

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[16] http://news.cnet.com/gamefly-acquires-direct2drive-pc-digital-distribution-service/8301-17938_105-20066077-1.html

[17] http://panasonic.net/avc/viera/global/connect_apps/area/1
[18] http://www.pcworld.com/article/2036160/what-the-console-ification-of-pcs-means-for-gamers.html
[19] http://www.pcworld.com/article/2029138/playstation-4-vs-pc-graphics-can-sony-even-compete-.html
[20] http://www.pcworld.com/article/2036160/what-the-console-ification-of-pcs-means-for-gamers.html
[21] Nintendo Wii utilizes the Wii Shop Channel to download video games, the Sony PlayStation family of consoles use the PlayStation Store, and the Xbox utilizes the Xbox Live Marketplace
[22] http://marketplace.xbox.com
[23] Ibid

While the current models of video game consoles provide the ability to download and store video games, the new Microsoft Xbox One and Sony PlayStation 4, both due to be released to the public in the Quarter 4 of 2013, will rely heavily on both downloadable and streaming of video games.[24] The Xbox One is expected to have a 500GB hard drive to store video games and games will be available for download directly from the Xbox Live Marketplace to the Xbox One's hard drive.[25] Additionally, consoles offer upgradeable storage that can significantly increase the storage capacity of the device.[26] In fact, even when the consumer chooses to buy the Blu-ray disc version of the video game instead of the digital download, the contents of the game will be transferred from the disc to the hard drive to permit faster processing by the Xbox One.[27] Furthermore, Xbox Chief Marketing and Strategy Officer Yusuf Mehdi, in an interview with Ars Technica, stated that "[w]e're trying to do something pretty big in terms of moving the industry forward for console gaming into the digital world. We believe the digital world is the future, and we believe digital is better."[28] The interview points out that while discs will still be an option for consumers, Xbox is looking to move consumers to digital downloads and cloud based (i.e. streaming) access to video games.[29]

Sony PlayStation 4 is also looking heavily to downloadable and streaming video games as the future. The PlayStation 4 will utilize an upgradable 500GB hard drive and will rely on downloading as the primary means for distribution of video games.[30] While customers will still be able to purchase discs from retailers, every game available for PlayStation 4 will be available online and customers can download and test each game before purchasing.[31] Streaming of games will also be available through PlayStation's sister company Gaikai, a cloud-based gaming service purchased by Sony in 2012.[32]

Mr. Hodess claims (Hodess Declaration at A-8 to A-9) that the availability and speed of broadband makes it infeasible for consumers to download video games and thus prohibits a robust marketplace. The speed and availability of broadband Internet connections has grown exponentially in the last several years. On August 18, 2013 the New York Times published an article identifying that "nearly 98 percent of American homes now have access to some form of high-speed broadband," an increase of about 8 percent in just 4 years.[33] The speed of broadband Internet access in the United States is also growing at significant rates with the current average Internet speed in the

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[24] http://business.financialpost.com/2013/08/20/playstation-4-to-go-on-sale-in-north-america-on-november-15-for-399-sony-lowers-vita-to-199/?__lsa=ab40-c796
[25] http://www.xbox.com/en-US/xboxone/what-it-is
[26] http://www.xbox.com/en-US/Xbox360/Accessories/HardDrives/Home
[27] http://www.polygon.com/2013/6/19/4446308/xbox-one-family-sharing-plan-cloud-library-price-cut-plans
[28] http://arstechnica.com/gaming/2013/06/microsoft-defends-the-xbox-ones-licensing-used-game-policies
[29] Ibid
[30] http://www.engadget.com/2013/06/11/sonys-playstation-4-eye-is-a-59-add-on-ps4-packs-a-500gb-hdd
[31] http://www.pocket-lint.com/news/119301-ps4-release-date-and-everything-to-know-before-pre-ordering
[32] http://www.theverge.com/2013/6/10/4417082/playstation-4-gaikai-streaming-sony-e3-2013
[33] http://www.nytimes.com/2013/08/19/technology/a-push-to-connect-millions-who-live-offline-to-the-internet.html?pagewanted=all

United States at 8.6 Mbps for Quarter 1 of 2013, a 27% increase over the same period in 2012.[34]

Mr. Hodess states (Hodess Declaration at A-12) that a 40-gigabyte game would presently take approximately eight hours to download on an average Internet connection. First, eight hours is a lot less time than it would take to receive a DVD game by mail. Second, while this calculation may be true based on the parameter provided, the majority of video games available today have sufficient capacity to efficiently download games in significantly less than eight hours. A survey of four video games shows required hard drive space of 8GB (Call of Duty: Black Ops II)[35], 20GB (Final Fantasy XIV: A Realm Reborn)[36], 10GB (Saints Row IV)[37] and 8GB (Sid Meier's Civilization V)[38]. None of these games approach the file size provided by GameFly, and the download time for Sid Meier's Civilization V, which is only 3GB in its compressed format for downloading, is estimated to be as short as 1 hour and 30 minutes.[39] The majority of gamers have access to faster Internet connections which are required for multiplayer gaming.[40] Broadband Internet is so ubiquitous in the gaming market that the Xbox One console was initially designed to always be connected to the Internet, and would even stop functioning if disconnected.

In addition to the console market, the downloadable PC video game market is extremely robust. The overwhelming majority of video games available for PC are currently available for download instead of physical purchase. Retailers such as Steam, Amazon, Best Buy and even GameFly itself (GameFly purchased Direct2Drive in 2011 which it renamed GF Direct) all offer video games for download. Many newer games are only available for download or available for pre-order so that consumers do not need to wait in line or wait for delivery of a physical copy.[41]

One feature offered by the Steam games marketplace is the ability to "sample" a game for a short period of time. Often used for promotional purposes, Steam will offer the game to users, completely free, for a limited duration. After the trial period ends, the Steam program asks the user to purchase the game, and if the user elects not to, the game is automatically uninstalled. All games in the marketplace require authentication to run, and the program simply withdraws authentication. Similarly, Amazon offers

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[34] http://www.akamai.com/dl/akamai/akamai_soti_q113.pdf?WT.mc_id=soti_Q113 at 14
[35] http://digitalbattle.com/call-of-duty-black-ops-2-system-requirements/
[36] http://www.ffxivinfo.com/systemreqs.php
[37] http://guide4games.com/fixes/saints-row-iv-fixes-for-pc-crashes-inauguration-station-issue-fov-and-errors
[38] http://steamcommunity.com/app/8930/discussions/0/864958451722126509/
[39] Ibid
[40] http://www.broadbandworldforum.com/presentation/super-fast-broadband-for-super-fast-games-market/
[41] http://venturebeat.com/2012/03/01/the-pros-con-of-pre-ordering/

digital copies of movies to rent that work on the same principal, and expire after a short amount of time.[42]

Streaming of Video Games Market

Mr. Hodess claims (Hodess Declaration at A-12) that streaming of video game content is ill-suited for the video game console market because the file sizes are too large, the broadband service is slow and unreliable and game latency frustrates consumers. Streaming of video games and online video game play is occurring today on PCs and video game consoles alike. Game such as World of Warcraft, which have been around for nearly a decade have relied on online gameplay and fast Internet connections to allow players to interact with each other in the game environment. Streaming services like OnLive recommend that users maintain a broadband connection of at least 5Mbps; the average speed in the United States is 8.6Mbps.[43] Video game publishers have already started to make the transition to these new services.

Contrary to Mr. Hodess' claims (Hodess Declaration A-8 -11) the streaming video game market is very competitive and is growing through acquisitions and new product launches. Gaikai, as discussed above, was acquired by Sony in 2012. As part of its new PlayStation 4 console, Sony announced that Gaikai would be utilized to provide both downloadable and streaming video game content to the PlayStation 4.[44]

OnLive, currently offers more than 300 titles of streaming video games from major video game publishers such as Atari, Capcom, Disney Interactive Studios, Sega, Square Enix, Take-Two Interactive, THQ, and Ubisoft. The game can be streamed to computers, OnLive MicroConsoles and televisions equipped with Google TV.[45]

G-cluster recently signed a distribution deal with Electronic Arts, a major video game publishing company. G-cluster has signed deals with more than 30 other video game publishers to providing streaming video games, including major publishers such as Ubisoft, Disney, Warner Bros., and Konami.[46] G-cluster is expecting to reach about 10 million households with its video game streaming platform by the end of 2013.[47]

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[42] http://www.amazon.com/gp/help/customer/display.html/ref=help_search_1-4?ie=UTF8&nodeId=200572830&qid=1377197616&sr=1-4

[43] http://www.akamai.com/dl/akamai/akamai_soti_q113.pdf?WT.mc_id=soti_Q113 at 14

[44] http://www.pocket-lint.com/news/119301-ps4-release-date-and-everything-to-know-before-pre-ordering

[45] OnLive recommends an Internet connection of 5Mbps with a minimum of 2Mbps. As set forth above, the average broadband speed in the United States is 8.6Mbps, significantly more than what is recommended by OnLive for streaming video game content.

[46] "http://venturebeat.com/2013/08/01/electronic-arts-teams-up-with-tokyos-g-cluster-to-provide-games-over-the-cloud-exclusive/

[47] http://www.consumerit.eu/index.php?option=com_content&view=article&id=1726:ea-joins-g-cluster-cloud-gaming&catid=25&Itemid=100021

ATTACHMENT A

I declare under penalty of perjury that the foregoing is true and correct.

Executed on August 22, 2013.

Mark S. Schoeman

ATTACHMENT B

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268–0001

COMPLAINT OF GAMEFLY, INC.	Docket No. C2009-1R
COMPETITIVE PRODUCT LIST ADDING ROUND-TRIP MAILER	Docket No. MC2013-57
COMPETITIVE PRODUCT LIST ADDING ROUND-TRIP MAILER (MC2013-57)	Docket No. CP2013-75

DECLARATION OF VIRGINIA J. MAYES

(August 21, 2013)

1. My name is Virginia J. Mayes. I am the Manager of Cost Attribution in Regulatory Reporting and Cost Analysis, part of the Finance Department at the United States Postal Service Headquarters. I previously provided testimony before the Postal Regulatory Commission (and Postal Rate Commission) on several occasions. In Docket Nos. R2005-1 and R2006-1, I provided testimony on the estimated cost avoidances used to support the Standard Mail and Periodicals destination entry discounts, the transportation costs for Parcel Post and Bound Printed Matter, and the estimated costs of Bulk Parcel Return Service. In Docket No, R2001-1, I testified on the estimated cost avoidances used to support the Standard Mail and Periodicals destination entry discounts. In Docket No. R2000-1, I was the Postal Service's witness on rate level proposals. I testified on rate design for Parcel Post in Docket Nos. R97-1 and MC97-1 and for domestic Express Mail in Docket No. R90-1. I was a rebuttal witness on behalf of the Postal Service in Docket No. MC93-1. I joined the Postal Service in 1987 as an

Economist in the Rate Development Division, subsequently renamed Pricing, served a detail assignment in Forecasting, and was the Acting Manager of Classification and Product Development. In 2000, I became the Manager of Special Studies, supervising the development of cost models and the estimation of workshare cost avoidances and Special Services costs. Prior to joining the Postal Service, I was employed with the economic consulting firm of Robert R. Nathan Associates. I had also worked as a statistician at the Bureau of the Census and as an economic analyst with the International Trade Commission. I received a Bachelor's Degree in Economics and Psychology from Washington University in St. Louis, and completed a Master's Degree in Economics at Brown University.

2. I submit this declaration in response to statements made in the August 15th "Comments of GameFly, Inc. on USPS Proposal to Reclassify DVD Mailers as Competitive Products," and the accompanying "Declaration of Sander Glick." For the reasons explained below, Mr. Glick's comments are inaccurate or incomplete and should be given no weight by the Commission. Additionally, contrary to the arguments made by GameFly, the Round-Trip Mailer product should appropriately be classified as a competitive product.

Comments in Response to the Declaration of Sander Glick

3. In the fourth paragraph of Mr. Glick's Declaration, he asserts that if the Commission gives weight to the cost data filed by the Postal Service on August 5, 2013, it would be denying "GameFly and other participants a fair opportunity to analyze and comment on the data." First, it is interesting to note that, despite Mr. Glick's concerns, GameFly did not request additional time to review the cost data. Second, the cost data was submitted pursuant to the Commission's request in Order No. 1794, which required the Postal Service to provide a financial analysis within four business days. Order No.

1794, Notice and Order on Request to Add Round-Trip Mailer Product to Competitive Product List, at 5 (July 30, 2013)(*hereafter* "Order 1794"). The Postal Service complied with the Commission's Order and all interested parties that requested access to the nonpublic materials had the same amount of time to review them.

4. Under the circumstances, the Postal Service attempted to develop estimated costs for the two companies from which the mail most likely to be included in the new Round Trip Mailer product would come. By way of explanation supporting the Postal Service's cost estimates, the following describes the justification for the analysis proffered in response to Order 1794. Permit Reply Mail (PRM) is used by Netflix for return mail pieces. These mail pieces are easily identifiable and exist in sufficient quantity to be readily observed and isolated at originating postal facilities. In addition, as Netflix is the largest user of the PRM category, the In-Office Cost System (IOCS) tally-based analysis of PRM costs effectively provides information regarding the costs of Netflix mail.

5. GameFly uses Business Reply Mail (BRM) for its return mail pieces. These mail pieces are not easily identifiable and do not exist in sufficient quantity to be readily observed and isolated at originating postal facilities. Direct Testimony of Troy R. Seanor on Behalf of the United States Postal Service, PRC Docket No. C2009-1 (July 29, 2010) at 17, 20. The relatively small quantity of GameFly pieces, the nondescript appearance of the GameFly pieces, and the fact that GameFly pieces are not massed at a large number of plants and handed over to GameFly or its agents, all conspire to make it difficult to develop any picture of costs for GameFly pieces, either in the existing classifications in which these pieces travel, much less in a new classification which could lead to changes in the mail characteristics. Hence, the use of existing flats costs as the proxies for the costs of Gamefly pieces. The estimates filed in response to Order No. 1794 provide a range of possible costs within which it is apparent that, should the mail in

question all shift to the new Round Trip Mailer category and not significantly change their characteristics, the costs would be covered by the prices that the Commission has required be charged.

6. In his fifth paragraph, Mr. Glick asserts that:

> The main problem with the cost estimates is that, other than the Permit Reply Mail (PRM) cost estimate used as a "lower-bound estimate" of the mail processing cost of letter-shaped DVD mail, the Postal Service has used generic cost data for mail of the same shape and, in some instances, machinability as proxies for the actual attributes and costs of DVD mailers. In the present context, this pervasive reliance on system-average data instead of DVD-specific data is inappropriate. One thing upon which all parties to this proceeding should be able to agree is that the mail flow for DVD mailers is unique, and thus the costs of other mail of the same shape are generally uninformative.

Mr. Glick's criticism that the cost estimates are inappropriate because they are "generic cost data for mail of the same shape and, in some instances, machinability" is unfounded. The Postal Service assumes that GameFly is not requesting that the Postal Service use generic cost data for mail that is ***not*** the same shape or machinability in lieu of the data the Postal Service put forth. The use of "generic cost data for mail of the same shape, and in some instances, machinability" as a proxy for the costs of new products, including Negotiated Service Agreements, has a long and continuing history. (See, for example, Docket Nos. MC2011-19 and R2011-3, in Excel file *Discover NSA.xls* wherein the unit costs for Discover's First-Class Mail and Standard Mail are derived by reference to the average unit costs from USPS-FY10-27 in Docket No. ACR2010. The Excel chart in USPS-FY10-27, named *NSA Unit Cost Detail Data Calculation.xls*, is updated annually and provided as part of the Annual Compliance Report for the express purpose of providing proxies to use in determining the costs of mail sent as part of Market Dominant NSAs.) The Postal Service does not know, a priori, what the costs of a new and unique product would be unless the new product is formed by shifting mail from an existing category in which its costs had already been isolated. Hence, the use of proxies from existing mail for which the costs are known.

7. Mr. Glick's characterization of the Postal Service's "pervasive reliance on system-average data instead of DVD-specific data" as being inappropriate is misguided and inconsistent with his criticism in paragraph 11 wherein he berates the Postal Service for trying to use data that ***is*** DVD-specific. The entire argument in the fifth paragraph of Mr. Glick's testimony is curious and seemingly at odds with previous GameFly positions. Either the GameFly return mail piece costs are the same as those for other flat-shaped mail pieces, in which case it is appropriate to use the generic data for flats, or they are not. GameFly has previously argued in Docket No. C2009-1 that its mail is not dissimilar to the costs of the flats categories to which it belongs.

8. The representation that "[o]ne thing upon which all parties to this proceeding should be able to agree is that the mail flow for DVD mailers is unique" and that this would obviate the use of existing data is incorrect. While all parties might agree that the DVD mail flow for Netflix PRM is unique when compared to non-Netflix single-piece letters, there is no evidence on the record that the DVD mail flow for GameFly BRM is any different than the non-DVD mail flow for other flat-shaped BRM mail pieces.

9. With respect to the costs of Netflix mail, the Postal Service offered a range of costs. The lower end of that range is represented by the IOCS tally-based analysis of the Permit Reply Mail which is dominated by Netflix mail. In order to provide assurance that the proposed prices will cover costs and to cover the possibility that the newly-created Round Trip Mailer product will attract mailers whose mail does not resemble the mail currently tendered by Netflix or GameFly, the upper-bound estimate using nonmachinable letters as a proxy was offered.

10. Furthermore, the Postal Service did not, as GameFly has claimed, simply use "generic cost data for mail of the same shape and, in some instance, machinability".

As the material presented in *DVD-RT FY14 CC Forecast.xls* (filed in nonpublic library reference USPS-MC2013-57/NP1) clearly shows, the Postal Service made adjustments to the unit costs. The costs of the inbound letters and flats, which were used as proxies for the inbound Round Trip Mailer pieces, were adjusted to remove window and delivery costs. These adjustments were made to reflect that the individuals returning the DVD material were not required to affix postage in order to do so, and thus, would likely avoid window transactions in most circumstances. Furthermore, as the Round Trip Mailer category would be dominated by Netflix mail and its characteristics, and given that Netflix engages agents to retrieve its mail from a large number of postal mail processing facilities, obviating the need for delivery, the delivery costs were also removed.

11. Mr. Glick is perhaps incorrect when asserting that the "mail flow for DVD mailers is unique." As the Postal Service has argued throughout the proceedings in Docket No. C2009-1, the mail flow for Netflix and the mail flow for GameFly pieces are *different*, not due to postal practices, but rather, due to the practices of these two companies. Thus, the Postal Service did not base its estimated costs for the Round Trip Mailer solely on cost proxies for Netflix mail; the estimates include costs for flat-shaped Round Trip Mailer pieces as well. However, because the Round Trip Mailer is a new product with new mail preparation requirements and the representation that all of the mail will be similarly handled, parallel adjustments were made to the inbound letters and flats cost proxies.

12. Mr. Glick may be correct in his assertion that the generic proxy is not appropriate for the calculation of inbound letter mail. The proxy presented in *DVD-RT FY14 CC Forecast.xls* includes a transportation cost for inbound letters. However, as was established in Docket No. C2009-1, Netflix picks up its mail at a large number of origin postal mail processing facilities, meaning that the letter-shaped DVDs would not be incurring any postal transportation aside from the intra-SCF transportation necessary

to move the DVDs from the originating associate office to the origin plant. As the Postal Service does not have a quantification of the number of letter-shaped DVDs that are not picked up at origin plants, an adjustment to that transportation cost figure would have been difficult. Accordingly, the entire Single-Piece First-Class Mail transportation cost was used in developing the inbound letter costs. Deleting transportation costs in their entirety from the inbound letter costs changes the values in cells P17 and P20 from 232.48% and 169.85% to 241.86% and 174.80%, respectively. The true transportation costs will lie between the Single-Piece Letter proxy and zero, but as the cost coverage is not endangered even by the more expensive proxy, it did not seem necessary, nor was there time to make an adjustment while meeting the timeline set by Order No. 1794. A similar adjustment to reduce transportation costs would not be appropriate for the inbound flats proxy, however, because Gamefly does not, as its usual business practice, send agents to a large number of origin mail processing facilities to pick up its mail.

13. Mr. Glick argues, in his sixth paragraph, that the use of “generic proxy data” for Netflix DVD mail is “clearly inappropriate.” The basis for his assertion is that “the process used to handle Netflix mailers differs greatly from the typical nonmachinable letter flow.” Mr. Glick then enumerates various aspects of the handling of Netflix mail that have been documented in Docket No. C2009-1, including:

"(1) culling by collectors,

(2) culling by Associated Offices and Stations,

(3) culling before and after dual pass/rough cull,

(4) culling by AFCS operators,

(5) exclusive use of EMM trays (special trays that are deeper than ordinary trays),

(6) sleeving of the EMM trays as a matter of practice,

(7) exclusive use of shelved allpurpose containers (“APCs”); and

(8) placing the EMM trays in the APCs in bricklaid orientation."); GameFly Reply Post-Hearing Brief (November 18, 2010) at 48-67 (citing record)."

The long, long list of activities is intended to make the process of handling Netflix mail look burdensome, but a simple examination of the list shows that it is somewhat nonsensical. If a piece is culled by a collector, it obviously would not also be culled by personnel at the Associate Office or Station, nor would it be necessary to cull before or after a dual pass/rough cull, and certainly the AFCS operator would not need to also cull the piece.

14. There has been no evidence proffered here, or in Docket No. C2009-1, to indicate that non-EMM trays are not sleeved, nor has there been evidence to indicate that other mailers with significant mail (for example, recipients of remittance mail) do not also have "exclusive use of shelved all-purpose containers", and there has been no testimony to indicate that the use of EMM trays, all-purpose containers, or even the practice of brick-laying the EMM trays, represent additional costs.

15. However, Mr. Glick's assertion that "the process used to handle Netflix mailers differs greatly from the typical nonmachinable letter flow" is correct. If the mail is culled early in the process, there would be no nonmachinable letter handling. The Netflix DVDs would be put into trays when culled, and aside from possible facing of the pieces, the pieces would never be handled again. The trays would also receive minimal handling, as most of them would be simply cross-docked and made available for the Netflix agent coming to the plant to pick up the mail. Nonmachinable letters, in general, would go through manual outgoing primary and possibly outgoing secondary handlings, be cross-docked and transported to downstream facilities – either a destination plant or a delivery unit, depending on the service area associated with the letter's destination – and then receive additional manual handlings as the piece was sorted to the appropriate

5-Digit ZIP Code and again to the appropriate carrier who would then have to case the letter. Because of the number of expensive manual handlings required for the typical nonmachinable letter, we viewed the costs of the nonmachinable letter to represent the upper bound of the handling cost for the letter-shaped inbound Round Trip Mailer pieces.

16. In his seventh and eighth paragraphs, Mr. Glick claims that the cost proxies overstate the flat-shaped DVD mailer costs in several ways. However, as is the case with any estimate, it is also possible that the cost proxies understate the costs. In fact, however, if *DVD-RT FY14 CC Forecast.xls* were adjusted such that the transportation and vehicle service driver costs for inbound and outbound flats were not adjusted for the average weight of the DVD flats but were removed *in their entirety*, the revenue received for the flat-shaped DVD mail would continue to be inadequate to cover the remaining costs.

17. It is unclear why Mr. Glick would want to discuss shape-specific costs at all as the Postal Service's analysis did not include shape-specific cost coverage estimates. If that analysis were revised to include shape-specific cost coverage estimates, the flat-shaped cost coverage values would fall well short of 100 percent, and it is doubtful that the modifications of any proxy costs would change that outcome. Furthermore, there is no foundation for his claims, as prior proceedings in Docket No. C2009-1 did not include an in-depth discussion of GameFly operations and costs.

18. The criticism, in the ninth paragraph of Mr. Glick's statement, that the use of the nonmachinable flat proxy to estimate VSD/transportation costs for inbound flat-shaped DVD mailers was inappropriate, need not be addressed for two reasons. First, because Mr. Glick himself addresses it: after stating that the use of the nonmachinable flat proxy is inappropriate, he states that "whether a piece is machinable or not should have no effect on VSD/transportation costs." Glick Declarationat ¶ 9. If it makes no

difference to VSD/transportation costs whether a piece is machinable or not, then it should make no difference to the VSD/transportation costs for inbound flat-shaped DVD mailers that the Postal Service used the nonmachinable flats cost as the proxy. However, Mr. Glick's observation caused a reexamination of the footnotes that support the cost calculation and the footnotes were found to be in error. In fact, the VSD and Transportation costs used to estimate the inbound flats costs were not those of nonmachinable flats, but rather, were for single-piece flats as a whole. A corrected version of DVD-RT FY14 CC Forecast.xls will be filed separately.

The New Round-Trip Mailer Product is Appropriately Classified as a Competitive Product

19. GameFly argues that the new product which will encompass round-trip DVDs should be a Market Dominant product. GameFly Comments, at 3. The Declaration of Mr. Mark Schoeman, filed simultaneously with my own, presents evidence that there are sufficient and increasingly strong competitive alternatives to the provision of the material that is the core of both the Netflix and GameFly business models. Just to mention one alternative available to the users of round-trip DVD rental through Netflix, Netflix itself offers a streaming video option for many of its popular movies, television shows and other forms of entertainment. Schoeman Declaration, at 3. It is not my intention to address all of the alternative means of providing similar entertainment currently offered via round-trip rentals through Netflix and GameFly, but rather, to emphasize that the impact on the volume of both Netflix and GameFly mail has been negative.

20. As discussed in the Declaration of Stephen W. Monteith, filed simultaneously to my own, Netflix's mail volume declined 58% since FY 2010. Monteith Declaration, at ¶3. Mr. Monteith's declaration also shows that GameFly volume declined 29% since FY 2011. *Id*. The decline in Netflix DVD activity has also been well-

documented in the company's 10K and 10Q filings with the Securities and Exchange Commission.

21. As the development of the average unit cost in the Excel file *DVD-RT FY14 CC Forecast.xls* shows, the estimated unit costs for the letter-shaped pieces – whether one refers to the upper bound or lower bound estimates – are far lower than the estimated unit costs for the flat-shaped items in the new product. As the Postal Service indicated in its initial request, the cost coverage for the new product at the proposed prices would not be endangered so long as no more than approximately forty percent of the volume in the new product was flat shaped. Request of the United States Postal Service Under Section 3642 to Create Round-Trip Mailer Product, *Statement of Supporting Justification*, at 2 (July 26, 2013). Given that the volume forecast provided by Mr. Monteith indicates that more than ninety-seven percent of the pieces in the Round Trip Mailer product would be letter-shaped, it seems implausible that the mail mix could ever reach the point where forty percent would be flat-shaped.

22. However, given the steep declines in Netflix volumes and the significant decrease in the price that the flat-shaped pieces would be paying as a result of the creation of this new product, the resulting mail mix and its commensurate average cost per piece should be considered. The large difference in unit cost between the letter-shaped and flat-shaped pieces would become more troublesome if the mail mix shifts toward a higher percentage of flats. It is fairly obvious from *DVD-RT FY14 CC Forecast.xls* that the letter-shaped mail pieces anticipated to dominate the Round Trip Mailer product will be effectively subsidizing the flat-shaped pieces within the same category due to the application of a single price for both types of mail and their disparate costs.

23. The potential decline in Netflix volume becomes problematic in another sense, as well. In the Excel file *FY09-12 MP 1st PRM Letters.xlxs*, submitted with this

declaration under seal as part of library reference USPS-MC2013-57/MP2, the volume of PRM is shown to have declined 4.9% from FY 2010 to FY 2011, and another 42% from FY 2011 to 2012. As the data show, the unit costs for PRM increased sharply from FY 2011 to 2012, 59%. This increase occurred when the average unit cost for First-Class Mail Single-Piece Letters decreased slightly more than one percent.

24. As previous postal testimony in Docket No. C2009-1 has described, the efficiencies associated with the culling activities and creation of the trays at the origin facility, usually at the initial mail processing operations, are related to the density of the Netflix mail. In its opposition to the operational remedy in that docket, the Postal Service has repeatedly stated that the process used to cull and tender Netflix mail to its agents would not be as efficient to use for GameFly mail, partly due to the much smaller volume of GameFly pieces. Fewer pieces per tray for each tray movement, fewer trays per APC, fewer pieces per culling operation would all conspire to reduce productivity and increase the average cost per piece. Further declines in the volume of the letter-shaped mail could decrease the effectiveness of the postal culling operation and could lead to further closings of Netflix distribution centers. Fewer Netflix distribution centers could mean fewer opportunities for the Postal Service to hand the mail to Netflix or its agents at origin facilities, and lead to increases in cost as the mail traverses additional postal facilities before being tendered to Netflix.

25. Declining volume, decreased densities, and the potential for a decrease in the dominance of the letter-shaped pieces in the new product would all aim towards a higher average unit cost. The Postal Service must have at its disposal the possibility of changing prices, as necessary, to ensure the continued viability of the new product. If the new product were included in the Market Dominant product listings, the price increases would be constrained by the CPI cap. If Round Trip Mailer were not subsumed within First-Class Mail as it is now, the CPI cap would apply directly and the

ability of the Postal Service to respond with pricing appropriate to the pressures that would increase the costs would be constrained.

26. Even if Round Trip Mailer were subsumed within First-Class Mail, the cap authority required to maintain Round Trip Mailer's cost coverage would, by necessity, not be available to use in pricing other mail in First-Class Mail which might represent a more fruitful application of the pricing authority. Neither Netflix nor GameFly need fear that the Postal Service would exercise undue vigor in raising their prices should the product be in the Competitive listing, however, as market forces would serve to constrain the Postal Service in price increases.

ATTACHMENT B

VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct. Executed on August 21, 2013.

Virginia Mayes

Virginia Mayes
Manager, Cost Attribution

Attachment C

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268–0001

COMPLAINT OF GAMEFLY, INC.	Docket No. C2009-1R
COMPETITIVE PRODUCT LIST ADDING ROUND-TRIP MAILER	Docket No. MC2013-57
COMPETITIVE PRODUCT LIST ADDING ROUND-TRIP MAILER (MC2013-57)	Docket No. CP2013-75

DECLARATION OF A. THOMAS BOZZO

(August 22, 2013)

1. My name is A. Thomas Bozzo. I am Vice President of Laurits R. Christensen Associates (LRCA), with offices at 800 University Bay Drive, Suite 400, Madison, WI 53705. I joined LRCA in 1996, and have since conducted or supervised numerous economic and statistical analyses of Postal Service cost and demand data on behalf of the Postal Service and USPS OIG. I have previously testified as a witness for the United States Postal Service on a number of occasions. In Docket No. R2006-1, I provided testimony (USPS-T-46) related to the design of the In-Office Cost System (IOCS) and the accuracy of IOCS mail identification data. I also supervised the production of IOCS-based mail processing costs for letter-shape Permit Reply Mail (PRM), including PRM cost data contained in *FY12 MP1st PRM Letters.xlsx* (filed on August 5, 2013 as part of USPS-MC2013-57/NP1) and *FY09-FY12 MP 1st PRM*

Letters.xlsx (filed today as part of USPS-MC2013-57/NP2). I received a Ph.D. in economics from the University of Maryland—College Park.

2. The purpose of this declaration is to respond to comments in the August 15, 2013 Declaration of Sander Glick, particularly the "concerns about the accuracy" of the IOCS-based PRM costs raised in paragraphs 11 and 12 of Mr. Glick's declaration. The Declaration of Virginia Mayes, submitted simultaneously to my own, critiques various other points made by Mr. Glick. I have read Ms. Mayes' declaration and agree with her analysis and conclusions.

3. Mr. Glick's stated concerns stem from the fact that PRM constitutes a small portion of the First-Class Single Piece Letters product. He contends that IOCS data are "particularly prone to error" in such cases, and cites several purported examples either directly or by reference to GameFly's November 26, 2010 Motion to Strike in Docket No. C2009-1. As I discuss below, when carefully examined, these examples do not support Mr. Glick's concerns regarding PRM.

4. Mr. Glick's first example is an issue related to attributing costs to Standard Mail flats and parcels. In this case, the problem was due to differences in the shape definitions used in IOCS and in Standard Mail rate application, rather than the relative sizes of the products. Docket No. R2006-1, USPS-T-13 at 34. Whereas shape in IOCS is based on mailpiece dimensions, rules for Standard Mail rate eligibility allow some pieces that are physically parcel-shape to claim flat-shape rates. The claimed rate category is not observable from mailpiece markings. IOCS data collectors correctly (per IOCS rules) record such pieces as being physically parcel-shape. The solution was not to correct an error of IOCS, but rather to develop adjustments to realign the costs with the associated volumes.

5. The second example from Mr. Glick's declaration is based on a claim of Pitney Bowes that some costs of presorted First-Class Mail (FCM) letters may be

misallocated to presorted FCM flats. Docket No. RM2011-3, Pitney Bowes Comments (February 28, 2011) at 2-3. While Mr. Glick characterizes this as an alleged IOCS problem, Pitney Bowes' comments make no specific mention of IOCS at all.[1]

6. Mr. Glick notes, by reference to GameFly's Motion to Strike, another type of IOCS error that does not appear to affect the PRM cost measurement. IOCS data processing was discovered to assign some costs for Outside County Periodicals to Within-County Periodicals in Docket No. R94-1. The issue here is that it is not possible to directly observe whether a Periodicals mailpiece claims Within-County rates from information on the piece—there is no applicable mail marking. In these cases, IOCS data collectors record the publication, and subsequent editing steps attempt to determine the specific Periodicals product. The problem was that the tally editing subsequent to field data collection produced false positives for Within-County eligibility based on an incomplete eligibility check. The solution was to incorporate mailing statement data to provide a more complete determination of whether Periodicals pieces observed in IOCS could have claimed Within-County rates. *See, e.g.*, Docket No. R2006-1, USPS-LR-L-9, Appendix D.

7. In contrast to the examples Mr. Glick raises, measuring PRM letter costs does not, in principle, raise issues of unobservable rate applicability or definitional differences between data systems. Permit Reply Mail is required to be marked with the legend "PERMIT REPLY MAIL" in large capital letters. See DMM 505 2.3.4. Based on my experience with testing the IOCS data collection instrument, I would consider PRM letters to be relatively easy to for IOCS data collectors and respondents to accurately identify due to the clear marking requirement. The Netflix mailer is, moreover, visually distinctive and letter-shape for the purposes of both IOCS and RPW.

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[1] Pitney Bowes draws its conclusion from discrepancies between RPW-by-shape and sample-based ODIS-RPW volumes for presorted First-Class Mail flats.

8. Mr. Glick states in paragraph 12 of his declaration that the Postal Service "appears to assume" that PRM letters are only inbound DVD mailers, and that he is "not aware of any evidence that this is the case." I conducted the PRM analysis with the knowledge that PRM letters are predominantly inbound Netflix DVDs, based on review of volume data provided in library reference USPS-MC2013-57/NP1. The data indicate that nearly all PRM letter volume—99.8 percent of PRM letter pieces in FY2012—is Netflix DVD returns. It appears that some, but perhaps not all, of the remaining 0.2 percent of PRM letter volume is also DVD returns. Regardless, the measured PRM letter unit cost is effectively a cost estimate for Netflix DVD returns.

9. In the end, Mr. Glick's concerns reduce to whether PRM cost is too small to be measured using the IOCS-based methods for mail processing costs approved by the Commission. PRM is indeed a small portion of Single-Piece FCM letters, but it is not too small to obtain a sufficiently reliable sample-based cost estimate. While bootstrap-based coefficients of variation (CVs) have not been estimated for PRM, it is possible to put a reasonable upper bound on the PRM CV using available results for products with similar costs. Based on the CVs in Docket No. ACR2012, USPS-FY12-NP21, a reasonable upper bound on the sampling CV for the IOCS-based PRM cost of 11 percent.[2] Consequently, the IOCS sampling standard error of the PRM unit cost estimate is on the order of 1.4 cents.

10. IOCS can have more substantial problems due to non-sampling errors when estimating costs for very small categories of mail, such as Standard ECR parcels. For the smallest categories of mail whose costs are measurable with IOCS data, even low-rate errors in responding to certain IOCS questions can cause non-sampling error to swamp the cost estimates. In such cases, the direction of bias due to this type of non-

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[2] This is based on the CV of Parcel Return Service, 11.09 percent. Parcel Return Service has a somewhat smaller mail processing cost than letter-shape PRM and would therefore be expected to have a higher CV, other things equal.

sampling error in such cases is clear: IOCS tends to overestimate the smaller category's costs. It should be noted that PRM is a much larger category of mail than the problematic small categories—e.g., 360.8 million pieces, versus 1.3 million ECR parcels. In contrast with problematic small categories that characteristically exhibit unreasonably high unit costs, the IOCS-based unit cost estimate for PRM letters is lower than that for the larger non-PRM single-piece FCM letter category. Thus, the PRM cost data are not symptomatic of Mr. Glick's stated concerns regarding small mail categories' costs.

Attachment C

VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct. Executed on August 22, 2013.

A. Thomas Bozzo

A. Thomas Bozzo
Vice President
Laurits R. Christensen Associates

ATTACHMENT D

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268–0001

COMPLAINT OF GAMEFLY, INC.	Docket No. C2009-1R
COMPETITIVE PRODUCT LIST ADDING ROUND-TRIP MAILER	Docket No. MC2013-57
COMPETITIVE PRODUCT LIST ADDING ROUND-TRIP MAILER (MC2013-57)	Docket No. CP2013-75

DECLARATION OF STEVEN W. MONTEITH

(August 22, 2013)

1. My name is Steven W. Monteith. I am the Manager of Transactions and Correspondence, part of the New Products and Innovation department at the United States Postal Service Headquarters. In my current position I am responsible for the development and implementation of products and services for First-Class Mail. This includes responsibility for First-Class letters, cards, and flats. As such, I have responsibility for the current round trip DVD product as well as the proposed competitive product. As part of my responsibilities, I am required to build business cases for proposed products and services. This requires me to collect and analyze data related to customers and industries that would participate in a product or service offer in order to project the financial impact of a particular offer.

2. The purpose of this declaration is to provide additional data that I have collected in the course of my duties related to the primary users of the proposed Round-Trip Mailer product, Netflix and GameFly. In that regard, two excel workbooks are being

submitted with my declaration under seal as library reference USPS-MC2013-57/NP2: 1) *Netflix-GameFly FCM Vol Charts.xls*; and 2) *Permit Reply Mail Customers.xls*.

3. Workbook *Netflix-GameFly FCM Vol Charts.xls* contains mailing volumes for Netflix (FY2007 thru FY2013) and GameFly (FY2011 thru FY2013). The data in this workbook was collected using CBCIS data collected for Netflix and GameFly. It should be noted that in the volumes for FY2013 we have identified double counting of some Netflix pieces beginning in November 2012. This was related to a double count of some Full Service IMb pieces as both an outbound piece and a piece receiving the IMb discount and occurred from November 2012 through June of 2013. To correct the double counting, appropriate adjustments were made to the data submitted under seal today. We also saw an anomaly in the counting of Business Reply Mail pieces in the GameFly data in September 2011, June 2012, and December 2012. Based on revenue per piece data we smoothed those months into an average BRM month in our analysis. With the stated adjustments we have seen a drop in Netflix volume of 58% since their high volume year in Fiscal Year 2010 and a drop in GameFly volume of 29% since Fiscal Year 2011.

4. Workbook *Permit Reply Mail Customers.xls* contains a listing of all Postal Service customers – and corresponding volumes from FY2011 thru FY2012 – that currently use Permit Reply Mail service. The data in this workbook was collected using CBCIS as a source. Based on this data, in Fiscal Year 2012, Netflix accounted for over 99% of the Permit Reply Mail for the Postal Service.

ATTACHMENT D

VERIFICATION

I declare under penalty of perjury that the foregoing is true and correct. Executed on August 22, 2013.

Steven W. Monteith

Steven W. Monteith
Manager, Transactions and Correspondence